

18 June 2010

Gary Henry  
Queensland Competition Authority  
GPO Box 2257  
Brisbane QLD 4001



Attention Liam Stewart

Dear Mr Henry

**Consultation Notice - Review of Electricity Retailer and Distributor Credit Support Arrangements**

ENERGEX welcomes the opportunity to contribute to the Queensland Competition Authority's (QCA) consultation on "Review of Electricity Retailer and Distributor Credit Support Arrangements".

ENERGEX supports the recent legislative amendments to the *Electricity Act 1994*, making the provision of credit support a retail authority condition and providing for the development of credit support guidelines. ENERGEX considers the current credit support arrangements under the Standard Co-ordination Agreement (SCA) to be generally adequate. However, ENERGEX has concerns regarding its inability to obtain sufficient credit support from retailers, the lack of enforcement mechanisms available to distributors and the timeliness of the dispute resolution process. These shortcomings were recently highlighted by the failure of a retailer and the resulting adverse financial implications for ENERGEX and other distribution businesses.

Credit support arrangements have been established to assist distributors mitigate their risks in the event that a retailer defaults on its network charges or a retailer of last resort event occurs. In mitigating distributors' risk, consumers are also offered some protection from potential flow through costs. Credit support arrangements need to incentivise retailers to provide upfront and ongoing credit support and pay their distribution service charges on time given that distributors have an obligation to continue to provide distribution services to customers regardless of whether retailers are meeting their financial obligations to distributors.

ENERGEX does not believe that the current credit support arrangements act as a barrier to entry or adversely impact retail competition. Retail competition in South East Queensland is relatively strong given the size of the market and that full retail contestability was only introduced three years ago.

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Ten retailers currently service Queensland's small customers of which some 40 percent have switched from regulated contract to a market contract. ENERGEX highlights that the majority of retailers operating in South East Queensland have provided credit support when requested in accordance with the SCA and that these retailers have accepted that this is a justified business cost.

The Australian Energy Market Commission's review into the effectiveness of competition in the electricity and gas retail markets in Victoria and South Australia concluded that credit support was not an impediment to effective competition in those states but rather provided a safeguard to the financial integrity of the energy market. The provision of appropriate safeguards becomes increasingly important given that the intention of National Energy Customer Framework (NECF) is for customers to ultimately meet the costs associated with retailer failures.

ENERGEX understands the QCA guidelines will be in place until the NECF comes into force in Queensland which is expected to be early 2012. ENERGEX has reservations about the NECF second exposure draft credit support arrangements as outlined in our public submission in January 2010. ENERGEX's key concerns include the complexity of the trigger for the provision of credit support, the complexity of the calculation of the credit support amount and potential for disputes arising from different interpretations of the calculation, the treatment of credit support disputes and the lack of effective enforcement mechanisms.

Credit support arrangements between distributors and retailers support the integrity of the electricity market in a similar way to the prudential arrangements between generators and retailers under chapter three of the National Electricity Rules (NER). ENERGEX understands that while distributors incurred substantial losses due to the recent failure of a retailer, wholesale market settlements payable by the retailer to generators through the Australian Energy Market Operator were met in full, by calling on prudential provisions established under the NER. The more stringent prudential arrangements between generators and retailers effectively resulted in generators being considered a higher order creditor than distributors (and their customers), despite both roles being equally critical in the delivery of electricity.

ENERGEX appreciates that the risk faced by generators is different, given the potential volatility of the wholesale electricity market. While distributors' exposures may be less volatile, the quantum can nonetheless be very significant. Moreover, distributors are limited in their ability to manage their risk through market solutions due to the regulatory framework. ENERGEX has unsuccessfully sought to obtain trade credit insurance for its total retailer portfolio as insurance companies will not offer any cover with respect to a number of retailers and the Australian Energy Regulator denied self insurance as an option. In ENERGEX's view, credit support is a justified cost to conducting business in Queensland or in the National Electricity Market (NEM) as is any other entry cost in other markets.

ENERGEX considers the current credit support arrangements under the SCA to be generally adequate, with the exception of enforcement mechanisms not being available to distributors and timely dispute resolution arrangements for non NER disputes. As such ENERGEX recommends the adoption of the current SCA triggers, amounts and forms of credit support for the QCA guidelines. In addition ENERGEX strongly recommends that the QCA guidelines recognise that an enforcement mechanism be available to distributors in the form of an objection code. ENERGEX proposes that the

objection code would, in very limited circumstances permit a distributor to prevent the transfer of any new customers where the retailer fails to provide adequate credit support in accordance with the QCA guidelines and therefore is in breach of the Electricity Act.

Credit support is closely related to retailer payment performance. The proposed objection code for failure to provide adequate credit support will also offer distributors some protection from payment default. Under the SCA and the NECF, failure by a retailer to pay a statement of charges within 25 business days of the due date, will trigger the need to provide credit support. Subsequent failure to provide credit support would then allow a distributor to object to the transfer of new customers.

The MSATS procedures allow jurisdictions to define objection rules. For instance, in Queensland retailers can object to the transfer of any customers to a new retailer for debt whereas in Victoria retailers can only object to the transfer of small customers for debt. Attached is the Queensland Government's Objection Code Guidelines 2003 for debt and contract as published on the Department of Employment, Economic Development and Innovation's website (**Attachment 2**).

ENERGEX intends to propose an amendment to the Electricity Industry Code shortly to include provisions allowing distributors to object to retailers obtaining new customers where the retailer has provided insufficient credit support. Such an amendment would bring Queensland's credit support arrangements in step with those in the United Kingdom (UK). The UK regulator the Office for Gas and Electricity Markets (Ofgem) "*Best Practice Guidelines for Gas and Electricity Network Operator Credit Cover*" permit network operators to suspend transfers to the defaulting retailer five business days after the due date.

ENERGEX is also seeking improvements to dispute resolution processes regarding credit support. ENERGEX's concerns regarding the non NER dispute resolution process is that it is lengthy and protracted with no timeframes specified. As retailers are able to prolong the dispute resolution process, ENERGEX would suggest the following:

- the QCA or an independent expert appointed by the QCA initially establishes if there are genuine grounds for a dispute;
- if the dispute is genuine and not frivolous and vexatious the QCA or an independent expert appointed by the QCA will make a determination that is final and binding; and
- if a determination has not been made within six months of the dispute resolution process commencing, either party may have recourse to litigation.

In summary, ENERGEX recommends that the QCA adopt the SCA triggers (for provision and review), amounts and forms of credit support in the development of its guidelines. In addition the guidelines must allow distributors to object to retailers winning new customers in defined circumstances, namely those retailers with inadequate credit support. The guidelines should also provide for improved dispute resolution processes which allow for more timely outcomes. This proposal will allow ENERGEX to best manage retailer credit risk for both ENERGEX and its customers. In the absence of these protections, the risk associated with retail competition should be borne by the beneficiaries of competition.

ENERGEX has provided high level comments to the QCA's specific questions in **Attachment 1**. Any questions regarding this submission should be addressed in the first instance to Leigh Henderson, by email to [leighhenderson@energex.com.au](mailto:leighhenderson@energex.com.au) or by telephone on 3223 1786.

Yours sincerely

A black rectangular redaction box covering the signature of Kevin Kenn.

Kevin Kenn  
Executive General Manager  
Strategy and Regulation

Attachment

## Attachment 1 – Response to Specific Questions

### 3.2 Current Trigger Mechanisms

- (a) ENERGEX considers that the trigger mechanisms for requiring the provision of credit support are set at an appropriate level and are relatively easy for ENERGEX to monitor. The difficulty experienced by ENERGEX to date has been that some retailers take a significant amount of time to provide verification of their credit rating or confirmation of a parent guarantee, and during this time, they continue to win new customers. Alternatively if the retailer is already active, and subsequently a trigger event enables ENERGEX to request credit support (or increase thereto), the retailer should not be able to continue winning customers if they do not provide the credit support within an appropriate timeframe.
- (b) ENERGEX acknowledges that obtaining a credit rating involves time and some expense for small retailers. However, ENERGEX considers this cost to be a justified business cost for operating in a market which promotes the integrity of the NEM by offering some protection to distributors and ultimately customers.
- (c) As above.
- (d) ENERGEX does not consider the provision of credit support to act as a 'barrier to entry'. Providing distributors with credit support is a cost of doing business in the retail market similar to other regulatory requirements including NER prudential requirements. The purpose of credit support is to ensure that retailers have sufficient financial backing to operate in the market. If not, both distributors and customers are at risk. There are a range of large and small retailers operating in the Queensland market that provide credit support, which demonstrates that the current credit support arrangements do not deter entry into the market.
- (e) ENERGEX closely monitors retailers' monthly bills and credit ratings. There is more than adequate incentive for ENERGEX to manage its accounts receivable; that is managing our cash flows and ultimately returning an appropriate dividend to shareholders.

### 3.3 Form and Provider of Credit Support

- (a) and (b) These are retailer issues. ENERGEX understands that retailers can obtain a bank guarantee from a multitude of providers. As the financial sector is highly competitive and access to capital has improved significantly since the global financial crisis, ENERGEX would expect that retailers would be able to seek out the lowest cost option. As discussed in ENERGEX's response, we have pursued trade credit insurance thoroughly, but no insurers approached would cover all retailers, and some terms & conditions proposed were unacceptable for the cost of the insurance.

### 3.4 Amount of Credit Support

- (a) ENERGEX bills all retailers monthly for meters read during that month. A retailers' billing cycle does not have any direct bearing on the amount of risk a particular retailer poses to a distributor. The risk a retailer poses is influenced by number of factors for instance the hedging strategy of the retailer.

- (b) ENERGEX does not consider that credit support equivalent to three months of estimated distribution charges creates an unacceptable barrier to entry for new entrants. The three months of estimated distribution charges is reflective of their potential default risk to distributors given that distributors only become aware of payment issues at the beginning of the second month after the period to which the distribution charges relate. As previously mentioned ENERGEX bills one month in arrears. A further month lapses with the invoicing and payment arrangements. The third month of estimated charges allows for resolution of any dispute or negotiation of a payment schedule. In the case of the recent retailer failure, ENERGEX's exposure was greater than three months of estimated distribution charges.

ENERGEX acknowledges that new entrants have some difficulty in estimating how many customers they are likely to win, the customer type (eg commercial or domestic) and likely consumption in order to estimate the next three months network charges. However, their business planning should be sufficiently detailed to be able to provide reasonably accurate information. Provided the estimates are reasonably accurate, having to provide credit support equivalent to three months network charges should not be a barrier to entry, but rather ensures the new retailer is not treated any differently to incumbents.

- (c) No. Incumbent retailers who incur the expense of obtaining a credit rating (so they do not have to provide credit support) should not be penalised by ENERGEX then not enforcing credit support requirements on those retailers who do not have a credit rating.

As noted in our main submission, ENERGEX does not support the proposed NECF approach to determining the amount of credit support due to its complexity and ambiguity, which will ultimately lead to unnecessary disputes

### 3.5 Review of Credit Support

The current provision actually requires the retailer to request that the undertaking be released. ENERGEX is satisfied with the current arrangements for the release of the credit support undertaking after six months if none of the triggers still apply.

### 3.6 Other Issues

#### *Drawing on Credit Support*

ENERGEX considers the current requirements for drawing on credit support provides sufficient time for retailers to fulfil their obligations.

#### *Dispute resolution*

As previously discussed ENERGEX found that through a recent dispute, the escalation process was very time-consuming, especially since the party could object to the appointment of the independent expert. ENERGEX notes that the dispute resolution process may be used as a way of delaying proceedings. Under the SCA, litigation can not commence until the dispute resolution process has been exhausted. Given the ability of retailers to delay the process, ENERGEX suggests that the dispute resolution process involves the following features:

- the QCA or an independent expert appointed by the QCA establishes if there are genuine grounds for a dispute;
- if the dispute is genuine and not frivolous and vexatious the QCA or an independent expert appointed by the QCA will make a determination that is final and binding; and

- if a determination has not been made within six months of the dispute resolution process commencing, either party may have recourse to litigation.

This places an onus on both parties to settle the dispute within a reasonable timeframe (six months) and allows both parties recourse to litigation.

*General issues*

ENERGEX considers that current credit support arrangements allow parties to appropriately mitigate their risk to counterparties without being administratively burdensome. ENERGEX would highlight that the current SCA arrangements are relatively straight-forward compared with the NECF, in particular the calculation of the credit support amount.

## QUEENSLAND OBJECTION CODE GUIDELINES

An objection to a customer transfer in Queensland can be raised by an existing FRMP in accordance with:

1. the CATS retail transfer procedures; and
2. these Objection Code Guidelines.

Any FRMP engaged in activating an objection code must ensure that in doing so, it does not breach any State or Commonwealth legislative requirement. This includes the appropriate use of these objection codes in accordance with the *Privacy Act 1988*.

### AGED DEBT

This objection code is used by the FRMP where a customer transfer is sought when the customer has an aged debt for the supply of electricity.

#### *Definition*

An aged debt is an amount owing by a customer to the FRMP in respect of a NMI (or group of NMIs) which:

- has been outstanding for at least 40 Queensland business days; and
- is in respect of the supply and sale of electricity or connection services.

#### *Application*

This objection code may only be used if all of the following are satisfied:

1. The customer's debt is an aged debt.
2. The aged debt is greater than \$4,000.
3. The customer is a large customer (i.e. contestable customer).
4. The objection is being raised with respect to change reason code series 1000 and 1020.
5. The objection is logged within five national business days (logging period). The FRMP must notify the customer of the objection within five national business days of activating the objection code. Notifications must include a written explanation of the reasons for the objection being raised and an explanation of any mechanism for the resolution of the objection.
6. The objection clearing period is 20 national business days. At 20 national business days, the change request becomes defunct.

## TERM CONTRACT

This objection code is used by the FRMP where a customer transfer is sought prior to the termination or end date of a term contract for the supply of electricity.

### *Definition*

A term contract:

- is a contractual arrangement between the customer and the FRMP;
- which, under the terms of the contractual arrangement, expires on a future date; and
- is in respect of the supply and sale of electricity or connection services.

### *Application*

This objection code may only be used if all of the following are satisfied:

1. The customer has an existing term contract with the FRMP.
2. The customer is a large customer (i. e. contestable customer).
3. The FRMP is not in breach of the conditions of the term contract.
4. The objection is being raised with respect to change reason code series 1000 and 1020.
5. The objection is logged within five national business days (logging period). The FRMP must notify the customer of the objection within five national business days of activating the objection code. Notifications must include a written explanation of the reasons for the objection being raised and an explanation of any mechanism for the resolution of the objection.
6. The objection clearing period is 20 national business days. At 20 national business days, the change request becomes defunct.

Whilst not an explicit requirement under these Objection Guidelines, there is an expectation that the FRMP will, in the first instance, examine the availability of penalties for early termination under the contract with the customer, as an alternative to the use of this objection code.

**DEFINITIONS**

In these Objection Guidelines and unless otherwise expressly stated:

*CATS retail transfer procedures* means the procedures outlined in the document “MSATS Procedures: CATS Procedures” and the document “MSATS – CATS Configuration Rules” issued by NEMMCO under the NEC, or such documents as replace these procedures from time to time.

*connection services* means services provided by a retailer in relation to the connection of a customer’s supply point.

*customer* means a person who buys or proposes to buy electricity from a retailer.

*FRMP* means the retailer who is the financially responsible market participant within the NEC.

*national business day* means a business day under the NEC.

*National Electricity Code* or *NEC* means the code outlining the market rules for market participants, NEMMCO and NECA.

*NECA* means the National Electricity Code Administrator.

*NEMMCO* means the National Electricity Market Management Company Limited.

*NMI* means national metering identifier.

*Queensland business day* means a day other than a Saturday or Sunday or a Queensland public holiday.

*retailer* means a person or entity who holds a retail licence under the *Electricity Act 1994*.