



Ref.: AC / CP

15 October 2010

Mr E J Hall
Chief Executive
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

97-99 Adelaide Street
Maryborough QLD 4650
PO Box 163
Maryborough QLD 4650
Telephone 13 10 46
Facsimile 07 4123 1124
Website www.ergon.com.au

Dear Mr Hall

Draft Decision – Review of Credit Support Arrangements

Ergon Energy Corporation Limited and Ergon Energy Queensland Pty Ltd (collectively referred to as Ergon Energy) welcome the opportunity to provide a submission to the Queensland Competition Authority's (QCA) consultation paper on the Draft Decision – Review of Credit Support Arrangements. This submission is available for publication.

Ergon Energy understands the approach that the QCA has taken in terms of adopting the credit support arrangements proposed in the National Energy Customer Framework (NECF) in Queensland to replace the current arrangements set out in the Coordination Agreement in order to achieve national consistency. Nonetheless, Ergon Energy continues to believe that the proposed NECF arrangements do not provide distributors with a reasonable level of protection from retailer credit risk.

Ergon Energy provides the following comments in relation to the QCA's Draft Guideline:

- Appendix B - Calculating Credit Allowance Percentage

Ergon Energy does not support the percentages outlined in Appendix B and believes that these are untenable from a risk management perspective. For example, companies that have a rating of **CCC** or **Severe** are not suitable for an unsecured credit limit. However this table provides a credit limit for companies otherwise considered to pose a severe credit risk. No credit allowance should be permitted in these circumstances.

- Appendix B – Dun & Bradstreet Risk Score

A material issue with reliance on the Dun & Bradstreet Dynamic Risk Score is that it will not reflect the true risk of a retailer if they are "new" to the market. In particular, the lack of a sufficient trading history could result in the retailer being rated more favourably than similar companies with an established trading history and therefore receiving a higher credit allowance. Typically, a lack of trading history will rate a company at average or below but not severe. A company with a severe rating will reflect that they have had collection activities or court actions against them or they are under administration.

Another issue that Ergon Energy observes with using the proposed formula to calculate a retailer's credit allowance based on the Dun & Bradstreet Dynamic Risk Score and the corresponding percentages outlined in Appendix B is that it does not take into account or allow the distributor to consider the size of the retailer. Dun & Bradstreet base the Dynamic Risk Score on the organisation's payment history and does not take into account the proposed credit limit or the average size of payments. For example:

- Company A has a net worth of \$10million, and pays suppliers 90% of the time within the terms and have an average payment per supplier of \$100,000. Dun & Bradstreet will allocate company A a "low" Dynamic Risk Score based on their good payment history.
- Company B has a net worth of \$1billion, and pay suppliers 90% of the time within the terms and have an average payment per supplier of \$10million. Dun & Bradstreet will also allocate company B a "low" Dynamic Risk Score based on their good payment history.

Using the proposed formula to calculate Company A and Company B's credit allowance under Appendix B will result in Company A and Company B both having the same unsecured credit allowance. If it is assumed that the total annual network charges for a distributor is \$1billion, the total credit allowance would be:

- Company A: $33.3\% \times 1,000,000,000 \times 7\% = \$23,310,000$
- Company B: $33.3\% \times 1,000,000,000 \times 7\% = \$23,310,000$

An unsecured credit allowance of up to \$23million might be reasonable for Company B, but it is certainly not reasonable for Company A. Company A will not be capable of making the same size payments as company B, due to being significantly smaller in size. The proposed calculation will force a distributor to give small and large retailers the same unsecured credit limit, regardless of whether they are capable of financially carrying such a credit allowance.

- Appendix B – Calculating Credit Allowance for Guarantor Guideline 3.4

Ergon Energy considers that there must be a positive obligation on a retailer to advise the distributor of any change to its credit rating immediately. Similarly, a distributor should be entitled to monitor or enquire about the credit rating information of a retailer's guarantor.

Ergon Energy continues to maintain that retailers that have credit ratings below investment grade should not be provided with a credit allowance.

Should you wish to discuss any aspect of this submission, please do not hesitate to contact me.

Yours sincerely



Carmel Price
Group Manager Regulatory Affairs

Telephone: (07) 4121 9545
Facsimile: (07) 4123 1124
Email: carmel.price@ergon.com.au