



17 June 2010

Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Via email: electricity@qca.org.au

To Whom It may Concern,

REVIEW OF ELECTRICITY RETAILER AND DISTRIBUTOR CREDIT SUPPORT ARRANGEMENTS

Queensland Electricity Pty Ltd ("QE") would like to thank the Queensland Competition Authority ("the Authority") for giving it the opportunity to make a submission on the points raised in their Consultation Notice titled "Review of Electricity Retailer and Distributor Credit Support Arrangements" released in May 2010.

By way of background, QE is a 100% owned entity of Victoria Electricity Pty Ltd ("VE"). The VE group retails electricity and gas to over 415,000 customers in Queensland, New South Wales, Victoria and South Australia. VE is 100% owned by Infratil Limited ("IFT") a company listed on the New Zealand Stock Exchange.

In reference to the areas raised in the Consultation Notice issued in May 2010, QE comment as follows:

The Authority seeks stakeholders' views on whether the current trigger mechanisms for requiring the provision of credit support:

(a) are too easy or too difficult for a distributor to activate; *QE considers that the current arrangements are too easy for distributors to trigger. Current arrangements provide distributors with high degrees of discretion and power with very little responsibility for reasonably assessing credit risk of the retailer and appropriate credit risk actions.*

(b) disadvantage smaller retailers that may have difficulty obtaining a suitable credit rating or accessing alternate forms of financial backing; *Smaller retailers will certainly be disadvantaged as they will not be able to obtain a suitable credit rating. This results in additional (and sometimes unnecessary) costs incurred by the retailer. In some instances, banking facilities might not be available to provide credit support. Distributors then have full discretion in*

requesting credit support regardless of the actual creditworthiness of the retailer. In other states, there has been examples where distributors have requested credit support even though they have acknowledged they face no credit risk from the retailer.

(c) disadvantage prospective retailers, as incumbents are more likely be able to obtain a suitable credit rating; *Incumbents will more than likely have a suitable credit rating, therefore not being required to provide credit support. This provides an unfair advantage to incumbents and puts them at a distinct cost advantage, discouraging competition in the market.*

(d) create a barrier to entry into the retail electricity market in Queensland; *The current arrangements increase the barriers to entry into the Queensland market as a distributor has full discretion on requesting credit support. The retailer will face heavy costs in providing this or alternatively may not be able to obtain funding facilities to provide the credit support (particularly given the recent financial crisis where funding is scarce); and*

(e) impose an adequate incentive for distributors to properly manage their accounts receivable. *The current arrangements provide no incentive for distributors to properly measure, assess and manage credit risk to retailers. They have full discretion in requesting credit support so this is their starting position.*

The Authority also seeks stakeholders' comments on whether any other trigger mechanisms may be more appropriate. *QE believes that a trigger mechanism similar to Victoria should be adopted whereby a credit allowance is determined for each retailer determined with reference to average distribution service charges and the retailers risk rating (which would need to be defined). This not only puts the onus onto the distributor to manage its credit risk but also onto the retailer to ensure it manages its financial performance and risk profile at a level it is viewed as a creditworthy counterparty. Ultimately, if the retailer falls below their determined credit allowance – they are required to lodge credit support.*

The Authority seeks stakeholders' comments on whether an unconditional undertaking issued by a bank:

(a) is the most cost effective means of obtaining a guarantee; *Retailers may be in a position to issue a guarantee other than a bank guarantee which are costly and sometimes not even available. Currently the distributors have too much discretion in determining who issues the guarantees. The distributors should be required to consider reasonable alternatives to a bank guarantee. For example, a parent company guarantee. and*

(b) disadvantages small retailers that may be unable to obtain an unconditional undertaking from a bank or may face significantly higher costs than a larger retailer, relative to their size. *Small retailers are definitely disadvantaged as costs of bank guarantees are high. However the real issue here is the retailers ability to access bank guarantees. Although the financial crisis seems to have passed, capital is still scarce making it hard and maybe in some cases impossible for smaller retailers to access capital for bank guarantees.*

The Authority also seeks stakeholders' comments on whether any other forms of credit support may be more appropriate. *Distributors should be required to consider all "reasonable" alternatives to an unconditional bank guarantee. This may include (but not limited to) parent company guarantees from organizations that meet certain standards or funding a credit insurance product that insures against the retailers default.*

The Authority seeks stakeholders' comments on whether requiring credit support equivalent to three months of estimated distributor charges:

(a) is appropriate given that retailers have different billing cycles and therefore pose different risks to a distributor; *The amount of credit support required should be determined based on a number of factors in assessing the actual risk to the distributor. Each retailer should receive a credit allowance with credit support determined by how much its average distribution charges exceed this allowance. QE believes this credit allowance should be calculated in a similar manner to the Victorian method.*

(b) creates an unacceptable barrier to entry for new entrants to the retail market by imposing a significant cost on start-ups which does not reflect their potential default risk to the distributor; *This really goes to the basis of determining whether credit support is triggered (see above comments)*

(c) imposes too high a cost on incumbent retailers if they are required to provide credit support. *No comment*

The Authority also seeks stakeholders' comments on whether any other approach to determining the amount of credit support may be more appropriate. *QE believes that distributors should be required to assess each retailer separately and based on this assessment calculate a credit allowance to the retailer. Credit support is then required for the amount of average distribution charges that exceed the credit allowance. This is a similar model used in Victoria and also proposed under the national regime.*

The Authority seeks stakeholders' comments on whether other timeframes for reviewing credit support may be more appropriate. *No Comment*

The Authority also seeks stakeholders' comments on:

- (a) whether the current credit support arrangements reflect best practice or whether**
- (i) there are other industries that may have adopted more suitable arrangements; or**
 - (ii) the credit support arrangements applying in any other jurisdiction are seen as providing a better model; and**
- (b) the extent to which the Authority should take account of the proposed national framework for credit support arrangements in developing its credit support guidelines.**

QE does not consider that the current arrangements are best practice for the reasons outlined above. QE has experience (via its parent) with credit support arrangements in Victoria. These are similar to what is proposed under the national framework. In QE's view these arrangements can be considered best practice in a market that is considered the most "competitive" in the world. They have been successful in assisting distributors protect against credit risk. It has resulted in lower electricity prices for Victorians and no doubt has aided retailer competition in that state.

The Authority should consider the proposed national framework. The national framework with regards to credit support arrangements no doubt considered the issues QE has raised above. It makes sense to be consistent with the proposed national framework. However, QE urges the Authority not to wait until the national framework is implemented. This could be some time off. QE believes the benefit of amending the credit support arrangements immediately greatly outweighs the costs.

If you have any further questions in relation to this submission, please do not hesitate to contact me on (03) 8680 6401.

Yours sincerely



Paul Forsyth
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Queensland Electricity Pty Ltd