



Final Decision

**Review of Credit Support
Arrangements**

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1. INTRODUCTION

Electricity distribution network service providers (distributors) operate in a regulatory environment where they must provide access to their distribution networks to all licensed electricity retailers. Given this obligation, it is generally accepted that, where appropriate, a distributor should be able to manage its risk of non-payment for distribution services by a retailer by means such as requiring a retailer to agree to credit support arrangements to be triggered in the event of non-payment by the retailer.

While such arrangements are primarily designed to protect distributors, they also protect end-consumers by ensuring that distributors can continue to provide distribution network services of a quality demanded by the community.

The National Electricity Rules (NER) provide that participants in the National Electricity Market (NEM), including electricity retailers, may be required to provide credit support to the Australian Energy Market Operator (AEMO). While the credit support arrangements under the NER are similar to those discussed in this paper, they are separate arrangements and have no direct connection to the credit support required for the supply of network services by electricity distributors.

1.1 Background

In Queensland, the credit support arrangements are currently contained in Clause 12 of the Queensland Default Coordination Agreement (the Coordination Agreement) where they are referred to as the Retailer's Performance Security. While the complete terms of the Coordination Agreement can be found in Annexure C of the Electricity Industry Code, the arrangements include:

- (a) distributors and retailers are free to negotiate their own credit support arrangements but, if they do not, the default Coordination Agreement applies;
- (b) distributors may request that a retailer provide an undertaking (credit support) if the retailer:
 - (i) does not have a, or has an unacceptable, credit rating;
 - (ii) has consistently failed to pay their bills by the due date;
 - (iii) has defaulted under the NER;
 - (iv) has ceased to be registered with AEMO; or
 - (v) has purchased energy from someone who has issued the retailer with a default notice; and
- (c) the distributor can request an amount of credit support of up to three months of estimated distribution charges in a form, and from an issuer, with which it is satisfied.

The existing credit support arrangements will remain in place until these Final Guidelines are enabled.

1.2 Review of credit support arrangements in Queensland

This current review of credit support arrangements arose from concerns that the existing arrangements might not be the most efficient method of providing protection for distributors and may be creating too high a barrier for retailers to enter the electricity market in Queensland.

There were also concerns that the dispute resolution and enforcement processes provided for in the existing arrangements were unwieldy and could take many months, during which time there was no means for a distributor to limit a retailer's use of the network.

As a consequence, on 21 April 2010, the Government amended the *Electricity Act 1994* (Electricity Act) and the *Queensland Competition Authority Act 1997* (the QCA Act) to require the Authority to develop guidelines for the credit support arrangements to apply between Queensland's electricity retailers and distribution entities (**Appendix 1**). The following relevant Sections were added to the Electricity Act:

- (a) Section 55DC makes it a condition of a retail authority that an electricity retailer must, if asked by their distributor, enter into and maintain credit support arrangements with that distributor. However, any credit support arrangements requested by the distributor must be consistent with the credit support guidelines (Guidelines) developed by the Authority or as otherwise agreed to between the distributor and retailer;
- (b) Section 120ZN(1) requires that the Guidelines developed by the Authority must, at a minimum, include consideration of the following matters:
 - (i) the circumstances in which a retailer may be required to enter into and maintain credit support with, or for the benefit of, a distributor (the trigger mechanism);
 - (ii) the types of credit support the Authority considers appropriate (the form of credit support);
 - (iii) the amount for which credit support should be provided (the amount of credit support); and
 - (iv) when and how credit support should be reviewed, including the amount of credit support (review of credit support).
- (c) Section 120ZN(2) requires that the Authority consult with distributors and retailers before making the Guidelines.

The Department of Employment, Economic Development and Innovation (DEEDI) considered that the inclusion of credit support requirements in a retailer's retail authority would provide a strong incentive for retail entities to provide the required credit support. Further, in the event a retail entity failed to provide credit support (and breached the retail authority condition), the proposed changes will allow the Regulator under the Electricity Act to intervene to limit any further credit risk to the distribution entity (using the existing processes in the Electricity Act for disciplinary action).¹

The Authority understands that the existing credit support arrangements will remain in place until these Final Guidelines have been enabled. At that time, the legislative changes will be given effect and the existing credit support arrangements will be removed from the Coordination Agreement and the new Guidelines will take effect.

On 25 May 2010, the Authority released a Consultation Notice seeking submissions from interested parties on the possible form and substance that the new Guidelines might take. The Authority also sought general views on what represented best practice arrangements for credit support, including issues such as dispute resolution.

¹ Mines and Energy Legislation Amendment Bill 2010 – Explanatory Note, available at <http://www.legislation.qld.gov.au/Bills/53PDF/2010/MELAB10Exp.pdf>

Ten submissions were received by the Authority. A copy of the Consultation Notice and the submissions received can be obtained from the Authority's website (www.qca.org.au).

On 23 September 2010, the Authority released its Draft Decision, along with Draft Guidelines. The Authority received five submissions in response to the Draft Decision – see **Appendix 2**. These can also be obtained from the Authority's website.

1.3 The National Energy Customer Framework

The National Energy Customer Framework (NECF) second exposure draft released in November 2009 included a proposed national Credit Support Regime.

Since the release of the Authority's Draft Decision, the NECF package of Bills was introduced into the South Australian Parliament on 27 October 2010. In addition, the associated Regulation and Rules, including those in relation to the credit support arrangements, to be made by the South Australian Minister have been released by the Ministerial Council on Energy.²

As discussed in the Draft Decision, DEEDI previously indicated that the bulk of NECF provisions, including credit support arrangements, are expected to be implemented in Queensland between January and July 2012.

1.4 Final Decision

This Final Decision confirms the Authority's Draft Decision to base the Queensland credit support arrangements on those presented in the NECF.

Chapter 2 of this Final Decision provides an overview of the Authority's Draft Decision and the submissions received in response

Chapter 3 outlines the Authority's consideration of the submissions received in response to the Draft Decision and provides the Authority's Final Decision. The Final Guidelines are contained in **Appendix 3**.

² Ministerial Council on Energy, *Standing Committee of Officials – Bulletin No. 185 – National Energy Customer Framework Update*, 5 November 2010.

2. DRAFT DECISION

In its Consultation Notice, the Authority sought comments on whether the current credit support arrangements reflect best practice or whether more suitable arrangements might operate in other industries or other jurisdictions. The Authority also sought comments on the extent to which it should take account of the proposed NECF credit support arrangements in developing its Guidelines.

Submissions in response to the Consultation Notice were generally of the view that the current credit support arrangements did not represent best practice and that the proposed NECF credit support arrangements provided a better model. Given this support for the proposed NECF arrangements and the commitment of the Queensland Government to implementing the NECF, the Authority's Draft Decision proposed to base the Guidelines on the NECF arrangements but with some amendments to address issues raised in submissions and to provide the clarity that appeared to be absent on some matters in the draft NECF. The proposed changes from the NECF provisions included:

- (a) aligning the Guidelines with Queensland rather than national legislation where appropriate, including the alignment of terminology with that in the Electricity Industry Code, rather than the National Electricity Law (NEL);
- (b) amendments that reflected worthwhile stakeholder suggestions aimed at clarifying or improving the processes, such as:
 - (i) ensuring that a distributor may not unreasonably withhold acceptance of an alternative (to a bank guarantee) form of credit support suggested by a retailer;
 - (ii) allowing distributors to require that retailers take action to preserve the value of credit support by changing credit support providers, if their current provider is under financial stress;
 - (iii) ensuring that retailers receive all the information that they need to meet their credit support obligations from distributors; and
 - (iv) allowing retailers to request a review of their credit support when they can demonstrate that the triggers for requiring credit support no longer exist.
- (c) clarification of terms used in the NECF and the inclusion of worked examples of the calculations used to determine the required level of credit support.

While enforcement and dispute resolution were raised by distributors as significant issues, these were not included as the Guidelines are to be enabled under the Electricity Act and will therefore be subject to the dispute resolution and enforcement provisions already provided for in the Electricity Act.

The Draft Decision also proposed to review the Guidelines in the event that material differences emerged in the final drafting of the NECF.

2.1 Submissions in response to the Draft Decision

Submissions received in response to the Authority's Draft Decision supported, or at least accepted, the rationale for the proposed alignment of the credit support arrangements with those proposed in the NECF. However, while some stakeholders (for example, Australian Power and Gas (APG)) also supported the minor amendments to the NECF arrangements proposed by the Authority, both Origin Energy and DEEDI suggested that the Guidelines should not deviate from the NECF arrangements.

While supporting the Authority's Draft Decision, APG considered that mechanism to trigger the provision of credit support in the NECF was too easy for distributors to activate.

Origin Energy suggested any deviation from the NECF arrangements would undermine the intent of the national arrangements and that, should the Authority proceed with its proposed amendments, the Authority should seek an NECF rule change to ensure alignment with the NECF is maintained.

DEEDI suggested that the amendments to the NECF arrangements the Authority had canvassed in its Draft Decision may lead to increased costs when Queensland transitions to the NECF arrangements. DEEDI also informed the Authority that the minor amendments it had proposed had either been considered and dismissed as part of the NECF consultation process or were effectively captured under other parts of the NECF arrangements and were therefore not required. Specifically, DEEDI noted that:

- (a) the proposal to include a provision for acceptance of an alternative form of credit support and the proposal allowing distributors to require retailers to take action to preserve the value of credit support were both addressed in the NECF consultation process. DEEDI considered that both proposals were unnecessary given the availability of a dispute resolution mechanism under the NECF; and
- (b) the inclusion of a provision requiring distributors to provide a retailer with estimates of the total annual retailer charges when determining a credit allowance and the provision allowing a retailer to request a distributor to review its credit support liability were not necessary as these were provided for in the NECF, despite the concern being raised by retailers.

Energex was of the view that the adoption of the NECF arrangements left distributors in a less favourable risk position than the existing arrangements. Energex was concerned that credit support amounts to be provided by retailers may decline compared with the existing arrangements and that issues around enforcement and dispute resolution would not be adequately addressed under the Electricity Act. Energex therefore remained of the view that a jurisdictional objection code as provided for under the AEMO Market Settlement and Transfer Solution Procedures should be introduced. The objection code would allow distributors to object to customer transfers to retailers where insufficient credit support has been provided was required. Energex also proposed a number of other additions to the Guidelines to clarify provisions with respect to a retailer's credit rating, the return of credit support and other retailer obligations.

Ergon Energy also suggested that the proposed NECF arrangements did not provide distributors with a reasonable level of protection from retailer credit risk. In particular, Ergon Energy did not support the credit allowance percentages contained in Appendix B of the Guidelines or the use of the Dun and Bradstreet Dynamic Risk Score for calculating a retailer's credit allowance.

Ergon Energy also suggested that the Guidelines should include a provision requiring a retailer to advise the distributor of any change to its credit rating immediately and that a distributor should be entitled to monitor or enquire about the credit information of a retailer's guarantor.

2.2 Changes to the NECF arrangements

Since the release of the Authority's Draft Decision, the final NECF arrangements have been introduced into the South Australian Parliament. The credit support arrangements contained therein have been amended from the second exposure draft which was available at the time the Authority prepared its Draft Decision. In particular:

- (a) an additional provision was added requiring a retailer to advise the relevant distributor of any change to its credit rating (or that provided by its guarantor) immediately on becoming aware of that change;
- (b) an additional provision was added allowing a distributor to obtain relevant credit rating information about a retailer (or its guarantor) and to monitor any ongoing changes to that credit rating;
- (c) the calculation of the maximum credit allowance has been revised and is now based on 25% of total annual retailer charges rather than 33.33% used in previous versions;
- (d) credit support allowance percentages (corresponding to the credit rating applicable to the retailer) used to determine credit support requirements have generally been reduced; and
- (e) changes have been made to the terminology used in the arrangements and a number of terms have been clarified.

The first two of these amendments improve the ability of distributors to monitor the credit support amounts provided by retailers and should therefore address some of the increased risk concerns raised by distributors in their submissions. Similarly, the reduction in the maximum credit allowance and credit support allowance percentages will effectively increase the amount of credit support payable by some retailers and therefore reduce the risk to distributors, a concern raised by Ergon Energy.

While none of the Authority's proposed amendments were specifically incorporated in the final NECF arrangements, the Authority is satisfied that the issues identified in the proposed amendments have either been previously considered or are largely incorporated in the finalised NECF arrangements.

3. FINAL DECISION

Given the Government's commitment to implement the final NECF arrangements and the general support from stakeholders for the NECF approach to credit support, the Authority considers that the Final Guidelines should, as far as possible, mirror the NECF provisions.

The Authority's Draft Guidelines canvassed the inclusion of a number of minor amendments to the then available NECF exposure draft to address practical issues associated with the operation of the Guidelines and other issues raised by stakeholders in submissions. At the time these amendments were proposed, the NECF arrangements were yet to be finalised and the amendments represented what the Authority considered would be useful additions to the final NECF.

In light of comments received in response to the Draft Decision, particularly the information provided by DEEDI who have been involved throughout the NECF negotiation and consultation process, and given the NECF has now been finalised, the Authority considers that it would be inappropriate to retain the minor amendments to the basic NECF provisions it had canvassed in its Draft Decision.

While the Authority notes Energex's concerns regarding dispute resolution and enforcement processes and the proposal to include amendments in the Guidelines to address these, the Authority considers that these are not required. As discussed in the Draft Decision, once the Guidelines are finalised, they are to be enabled under the Electricity Act and will therefore be subject to the dispute resolution and enforcement provisions already provided for in the Electricity Act. This approach is consistent with that adopted in the NECF, where disputes are addressed under the dispute resolution mechanisms under the NEL. Once the NECF are introduced into Queensland, the Electricity Act will no longer apply and any credit support disputes will be subject to the NEL.

In light of these considerations, the Authority considers that the Credit Support Guidelines should be aligned as closely as possible to the corresponding provisions in the NECF. The Authority agrees with Origin Energy and DEEDI that, now the NECF has been finalised, to do otherwise could hinder the smooth transition to the NECF arrangements once these are implemented in Queensland.

Notwithstanding the above, there are some changes that are still required to reflect the fact that these Guidelines are to be established under the Electricity Act rather than the NEL. As a result, some amendments to the wording use in the final NECF are required to facilitate the operation of the Guidelines in this context. These amendments link the Guidelines to existing Queensland legislative arrangements and will fall away (together with the Guidelines) once the NECF is implemented.

The Authority's Final Decision therefore is to prepare credit support guidelines that are the same as the credit support arrangements set out in the finalised NECF, but with the following amendments:

- (a) the Guidelines are subject to the Electricity Act dispute resolution and enforcement provisions, rather than those in the NEL (see Clause 4.4 of the Draft Guidelines);
- (b) the Guidelines use the "Statement of Charges" as outlined in the Coordination Agreement, rather than "Statement of Charges" provisions in the NECF (see Glossary of the Final Guidelines);
- (c) the provision which regulates how distributors may draw on credit support (Clause 5.3 of the Draft Guidelines) references the disputes relating to the "Statements of Charges"

developed according to the requirements of the Coordination Agreement. The NECF uses its own specific dispute resolution mechanism relating to the treatment of “Statements of Charges” which sits in the proposed NECF, outside the credit support arrangements;

- (d) where appropriate, the Guidelines use definitions from the Coordination Agreement and the Electricity Act, rather than from the NECF, NEL or the National Electricity Rules; and
- (e) worked examples have been attached to the Guidelines to assist stakeholders in the calculation of credit support requirements.

The Final Guidelines are contained in **Appendix 3**.

APPENDIX 1 – LEGISLATIVE AMENDMENTS

Mines and Energy Legislation Amendment Bill 2010
Part 4 Amendment of Electricity Act 1994

[s 37]

Clause 37	Insertion of new s 55DC	1
	After section 55DB—	2
	<i>insert—</i>	3
	‘55DC Additional condition about credit support	4
	‘(1) It is also a condition of a retail authority that the retail entity must, if asked by a relevant distribution entity, enter into and maintain credit support with, or for the benefit of, the relevant distribution entity.	5 6 7 8
	‘(2) However, the condition applies to a retail entity in relation to a relevant distribution entity only if the credit support requested by the distribution entity—	9 10 11
	(a) is consistent with the credit support guidelines; or	12
	(b) otherwise—is agreed to in writing by the distribution entity and the retail entity.	13 14
	‘(3) In this section—	15
	<i>credit support</i> , in relation to a retail entity and a relevant distribution entity, means an arrangement to mitigate the risk of exposure of the distribution entity to non-payment by the retail entity of distribution non-network charges, network charges or any other charge payable by the retail entity to the distribution entity.	16 17 18 19 20 21
	<i>Example—</i>	22
	bank guarantee, third party guarantee or shareholder guarantee	23
	<i>distribution non-network charges</i> see section 90(10).	24
	<i>network charges</i> see section 90(10).	25
	<i>relevant distribution entity</i> means a distribution entity with which the retail entity has common customers.’.	26 27
Clause 38	Insertion of new ch 5, pt 1B	28
	Chapter 5—	29
	<i>insert—</i>	30

Mines and Energy Legislation Amendment Bill 2010
Part 4 Amendment of Electricity Act 1994

[s 39]

'Part 1B	Credit support guidelines	1
'120ZN QCA must make credit support guidelines		2
'(1) QCA must make guidelines (the <i>credit support guidelines</i>) about the following matters—		3 4
(a) the circumstances in which a retail entity may be required to enter into and maintain credit support with, or for the benefit of, a distribution entity;		5 6 7
(b) the types of credit support QCA considers appropriate;		8
(c) the amount for which credit support should be provided;		9
(d) when and how credit support should be reviewed or revised, including the amount of credit support;		10 11
(e) any other matter relating to providing credit support that QCA considers relevant.		12 13
'(2) Before making the credit support guidelines, QCA must consult with distribution entities and retail entities.		14 15
'(3) QCA must publish the credit support guidelines on its website.		16 17
'(4) The credit support guidelines take effect on the day stated in the guidelines for that purpose.		18 19
'(5) In this section—		20
<i>credit support</i> see section 55DC(3).'		21
Clause 39	Amendment of sch 5 (Dictionary)	22
	Schedule 5—	23
	<i>insert</i> —	24
	' <i>credit support guidelines</i> see section 120ZN(1).'	25

Mines and Energy Legislation Amendment Bill 2010
 Part 12 Amendment of Queensland Competition Authority Act 1997

[s 93]

Part 12	Amendment of Queensland Competition Authority Act 1997	1 2
Clause 93	Act amended	3
	This part amends the <i>Queensland Competition Authority Act 1997</i> .	4 5
Clause 94	Amendment of s 10 (Authority's functions)	6
	Section 10—	7
	<i>insert—</i>	8
	'(ka) to make credit support guidelines under the <i>Electricity Act 1994</i> ; and'.	9 10

APPENDIX 2 – LIST OF STAKEHOLDERS**Table A1: Submissions to Draft Decision**

<i>Organisation</i>
1. Australian Power and Gas
2. Energex
3. Ergon Energy
4. Department of Employment, Economic Development and Innovation
5. Origin Energy
