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Retail Advisory Group
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Retail Advisory Group Discussion Paper: Retail Customers in Retail Default Situations

Unison welcomes the Retail Advisory Group's (RAG) consideration of the implications for consumers should an electricity retailer default.

This letter constitutes Unison's submission on the Discussion Paper.

Regulatory intervention

In the examination of the Authority's statutory objective as part of the evaluation of possible solutions to retailer default, we strongly support the view that "market arrangement should be durable in the face of high impact, low probability events, or the impending prospect of those events occurring".[1]

Unison submits that although there is a low probability that an electricity retailer will fail to pay amounts due to the Clearing Manager or an electricity distribution business (EDB), there may be extremely high consequences to market participants in a retailer default situation. While past experiences of retailer difficulties may indicate that the likelihood of a retailer default is low and market arrangements have been effective in ensuring consumers are not left without a retailer, Unison submits that the market is now very different and it is too risky not to put in place arrangements that would promote an orderly transfer of consumers (e.g., wholesale prices may be much higher in future than in the past as signalled by the March 2011 UTS, Huntly units are being retired which previously provided dry-year capacity).

The high consequences resulting from ineffective arrangements for managing a retailer default situation are recognised in the Discussion Paper. The potential for disruption to electricity supply, financial impact on market participants, uncertainty and inconvenience for consumers (including the risk of disconnection of electricity supply), and damage to the credibility of the market are not insignificant impacts.

[1] *Retail Customers in Retail Default Situations* - RAG Discussion Paper; 7 February 2012, page 26.

Due to the high consequences, we believe there needs to be a regulated process implemented by the Authority for market participants to follow in case of default. A high degree of certainty is needed around the process and timeframe after an event of default to ensure any consequences are minimised. The approach decided upon also needs to be stress tested, to ensure there is confidence by the market participants of the process.

From EDBs' perspectives, the consequences of an event of retailer default are closely linked to the recent amendment to the prudential requirements in the Electricity Participation Code (Code). The Code amendment provides that a retailers must elect to comply with prudential requirements in the form of either an 'acceptable credit rating' (BBB-) or 'acceptable security' (two weeks of line charges). The Code allows an EDB to specify in its Use of Systems Agreement a maximum of two months' worth of line function charges, but with the requirement that the distributor pay the retailer a financing charge equal to a 15% margin above the 90 day bank bill rate on any cash bond or third party security required in excess of two weeks.

This amendment truncates an EDB's ability to use the cost effective mechanism of prudential requirements to manage its exposure to retailer default risk. Prudential requirements set at two weeks of line charges would cover only a small proportion of the potential time when a retailer may be in default. Due to the payment timeframes and potential for delays in identifying default, as well as potential for delay as troubled retailers' seek injections of capital, there could be an extended period where a distributor bears the cost of default. The previous status quo of setting prudential requirements at two months of line charges would have better ensured that there was a matching of the period when a retailer may be in default and timeframes for switching of consumers to alternative retailers.

Without a regulated process in addition to reduced prudential requirements, there will be a lack of confidence in market arrangements, which is likely to result in increased mitigation activities. This will ultimately involve a cost to the end consumer. It is highly probable, EDBs will review what actions they can take to alleviate retailer default risk; resulting in less efficient means of managing this risk, including some or all of the following:

- Monitoring of retailers behaviour. EDBs may require regular reporting of retailers' hedge positions to ensure that they are not unduly exposed to high spot prices, which may become more prevalent under the Commission's scarcity pricing proposals.

- The setting of barriers in the way of perceived more risky new entrants.

- Adjusting payment terms to reduce the timeframes for exposure to default. Transaction costs would increase if the frequency of billing cycles is increased.

- Introduction of arrangements to disconnect or reduce consumption of consumers of defaulting retailers, leading to inefficient use of electricity.

- Putting in place different tariff schedules according to the perceived risk profile of the retailer.

We are also concerned that a key focus for the options for additional intervention contained in the Discussion Paper is on the re-establishment of a legal basis for the appointment of a receiver should a retailer default. While that is obviously important, the Authority should not unduly focus on that aspect. There may be a multitude of reasons for a retailer default outside of a failure to make payments in the wholesale market. As noted in the Discussion Paper the mechanism to appoint a receiver does not provide complete certainty that all customers in all circumstances would be transferred smoothly to a viable retailer.

Unison ultimately concludes that the Authority prudently should put in place regulated arrangements to manage a case of retailer default to provide comfort to all market participants. A high degree of certainty is needed around the process and timeframe after an event of default to ensure any consequences are minimised.

Please let me know if we can provide any other assistance.

Kind regards,

Nathan Strong
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