

SAIIR



**ELECTRICITY SECURITY
DEPOSITS AND INTEREST ON
LATE PAYMENTS**

FINAL REPORT

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1. INTRODUCTION

1.1. Retail Code

The Retail Code under the Independent Industry Regulator (IIR) Act came into operation on 11 October 1999 (and was varied on 23 December 1999).

The Retail Code regulates the terms on which a retailer can sell electricity to non-contestable customers, ie. customers who are unable to choose their electricity retailer. Contestable customers (currently those customers who use more than 160 MWh per annum) can negotiate their own customer sale contract.

From 1 January 2003, the Retail Code will apply to all customers who consume less than 30 MWh per annum.

Currently there is only one licensee who holds a retail licence to which the Retail Code applies. That licensee is AGL South Australia (AGL).

1.2. Retail Code requirements of Industry Regulator

The Retail Code under the IIR Act provides the Industry Regulator with power to make certain determinations. In particular, the Retail Code provides:

σ **Interest on late payments (Clause 6.3.3)**

The Industry Regulator must approve the amount of interest which may be charged on late payments of electricity accounts. It should be noted that while the Retail Code does not presently empower the Industry Regulator to specify the terms and conditions on which late payment interest will be applied (eg. from when, and to whom, it should apply), this matter will be considered when the Retail Code is reviewed. However, the Retail Code provides that a retailer must offer a residential customer an interest free instalment plan to give a customer more time to pay a bill or arrears.

σ **Level of Security Deposits (Clause 8.1)**

The Industry Regulator must approve the amount proposed by retailers as security deposits for various categories of customers.

The Industry Regulator must determine the average quarterly and monthly bill for each category of customer (this determines the maximum security deposit allowable).



σ **Interest on Security Deposits (Clause 8.4)**

The Industry Regulator must approve the interest rate, and terms and conditions on which interest is paid, on security deposits held by the retailer.

1.3. The Retail Code and other information

Background information about the role and functions of the SAIIR and a copy of the Retail Code are available from the SAIIR web-site, www.saiir.sa.gov.au, in the Electricity Industry/Regulatory Framework section.

1.4. Public Consultation

In July 2000, the Industry Regulator released a Public Discussion Paper in which were identified a range of issues for comments by interested parties, with regard to Retail Code provisions for security deposits and late payment interest.

Responses to the Discussion Paper formed the basis for a Draft Report that was issued in October 2000 for a short period of further consultation.

A list of persons and bodies to whom the Discussion Paper and Draft Report were circulated, and a list of submissions received, is included in the Appendix to this Report.

1.5. Final Report

This Report sets out the decisions of the Industry Regulator in relation to the levels of security deposits, and the interest rate payable on late payments and security deposits. The decisions by the Industry Regulator will apply from 1 January 2001.

2. SECURITY DEPOSITS

2.1. What is a security deposit?

Under the Retail Code, a security deposit is defined as an amount of money or other arrangement acceptable to the retailer as a security against a customer defaulting on a bill.

2.2. Average Quarterly and Monthly Bills

2.2.1. Retail Code Provisions

The Retail Code makes the following provision:

8. Security Deposits and Alternatives

8.1 Security Deposits

8.1.1 *The Retailer may require a retail code customer to provide a security deposit at the time the retail code customer makes an application for [connection] or an application for reconnection after being disconnected..., or before selling electricity to the retail code customer.*

Subject to approval and annual review by the Industry Regulator and Clause 8.3.3 (which deals with increases in security deposits):

- (a) the amount of a security deposit for a retail code customer who is on a quarterly billing cycle must not be greater than 1.5 times the average quarterly bill; and*
- (b) the amount of a security deposit for a retail code customer who is on a monthly billing cycle must not be greater than 2.5 times the average monthly bill.*

The average quarterly and monthly bill for each category of customer will be as determined by the Industry Regulator from time to time.

2.2.2. Average Quarterly and Monthly Bills – Security Deposit Cap

The Retail Code sets out a cap on security deposits. The security deposit for a customer on a quarterly billing cycle cannot be more than 1.5 times the average quarterly bill and for a customer on a monthly billing cycle the security deposit cannot be more than 2.5 times the average monthly bill.

The Retail Code requires the Industry Regulator to determine the average quarterly and monthly bill for each category of customer from time to time.



AGL advises that, in general, residential customers are billed quarterly, whereas non-residential customers are billed quarterly or monthly depending on their level of consumption.

AGL provided information to the Industry Regulator, analysing billing data for all quarterly billed customers (approximately 722,000). This analysis demonstrated that the average quarterly bill for residential and business customers billed quarterly, in a one year period (March 1999 – Feb 2000), was \$202.

For monthly billed customers, AGL advised that due to the very large variation in business usage, it was difficult to identify a meaningful single average bill. For this analysis, AGL took into account all monthly-billed customers using less than 160MWh per annum (approximately 10,000). This analysis demonstrated that the average monthly bill for business customers using less than 160MWh per annum, in the one-year period analysed, was \$615.

The Industry Regulator is satisfied with the method used by AGL to assess average quarterly and monthly bills.

2.3. Final Decision – Average Quarterly and Monthly Bill

The Industry Regulator's decision is that the average quarterly and monthly bill for the following categories of customer is:

| | |
|-------------------------------|-------|
| AGL quarterly billed customer | \$202 |
| AGL monthly billed customer | \$615 |

2.4. Requirement to provide a security deposit

2.4.1. Retail Code provisions

The Retail Code provides:

8.2 Residential Customers

A retailer must not require a residential customer to provide a security deposit unless:

- (a) the residential customer has left a previous supply address without settling an outstanding electricity debt, the debt remains outstanding, and the residential customer refuses to make arrangements (acceptable to both parties) to pay the debt; or*
- (b) the residential customer has within the previous two years been responsible for the use of electricity contrary to clause 5 [illegal use of electricity]*

- (c) *the residential customer is a new customer and has refused or failed to produce acceptable identification and credit history information; or*
- (d) *the retailer has, offered the residential customer an instalment plan or other payment option and the residential customer has refused, or failed to agree, to the offer.*

8.3 Business Customers

8.3.1 *A retailer must not require a business customer to provide a security deposit unless:*

- (e) *the business customer does not have a satisfactory credit rating; or*
- (f) *the business customer does not have a satisfactory electricity account payment history.*

8.3.2 *A retailer must accept from a business customer a bank guarantee as an alternative to a cash security deposit*

8.3.3 *...A retailer may increase a business customer's existing security deposit where that security deposit is insufficient to secure the business customer's current electricity usage taking into account the limits on security deposits ... using the average of the customer's last three bills.*

2.4.2. Limited circumstances in which security deposit can be required

The Retail Code does not envisage that all customers will pay a security deposit.

The Retail Code only permits a retailer to require a security deposit from a residential customer when the customer has unpaid bills from a previous supply address, has misused electricity, has not produced acceptable identification and credit history, or when the customer has refused an offer of an instalment plan.

For business customers, a security deposit can only be required where the business customer does not have a satisfactory credit rating or does not have a satisfactory electricity account payment history.

AGL advises that, as at May 2000, it held security deposits from 24,885 residential customers, which is approximately 4% of residential customers.

In addition, as at May 2000, security deposits were held from 1,390 business customers, which is approximately 1.5% of business customers.

2.5. Return of Security Deposits

The Retail Code requires that a security deposit and any interest be returned to a customer when the customer completes 12 months (or such lesser time agreed with the retail code customer) of paying bills by the pay by dates for those bills or the customer ceases to



purchase electricity from the supply address. The security deposit may be credited to the next bill or otherwise dealt with in accordance with the customer's instructions.

Only if the customer fails to pay a bill and the supply address is disconnected, or where a final bill is issued when a customer vacates a supply address or ceases to buy electricity at the supply address, may the retailer use a security deposit and interest which has accrued to offset an amount owed by the customer to the retailer and/or the distributor.

2.6. Interstate use of security deposits

The recently released *Electricity Distribution Businesses - Comparative Performance Report for the Calendar Year 1999*, issued by the Office of the Regulator General in Victoria, highlights considerable differences between the use of refundable advances in that State compared to the use of security deposits in South Australia.

In Victoria the average number of refundable advances across all five distribution businesses for domestic customers was 445 advances. This figure has remained constant since 1997. There are currently over 2 million customers in Victoria. This means that 0.02% of domestic customers in Victoria are required to pay a security deposit. This figure has fallen from 0.06% of residential customers in 1996. The average amount held as a domestic security deposit in Victoria is \$271. It is extremely rare for a residential customer to be required to pay a security deposit in Victoria.

These figures can be contrasted to the 24,885 residential security deposits held by AGL in South Australia at May 2000, equating to 4% of residential customers.

For Victorian business customers, 17,250 refundable advances were held, equating to 7.7% of all business customers. This figure has fallen from 9.96% in 1996. The average amount held for a business customer is \$592. The Office of the Regulator General in Victoria considers the relatively high number of business customers on refundable advances is primarily due to use by CitiPower, the CBD distribution business, that has a high turnover of small customers in its network area.

In South Australia, AGL held security deposits from 1,390 business customers, or 1.5% of its business customers. It has been suggested that the relatively low number of business security deposits in South Australia may be due to the different historical structure as regards the reselling of electricity by commercial landlords to commercial tenants. This means that tenants are not generally the direct customer of an electricity retailer in South Australia.

In Victoria, the maximum amount of security deposit is determined in the same way as in South Australia – ie. 2.5x average monthly bill and 1.5x the average quarterly bill. In NSW the amount of security deposit required from domestic and business customers by each franchise retailer must be no greater than 1.5x the average quarterly account, 1.75x the average two-monthly account, and 2.5x the average monthly account

2.6.1. Comparison between Victoria, New South Wales and South Australia

In Victoria refundable advances can only be required of new domestic customers who fail to provide acceptable identification. Acceptable credit history is not a criterion. This alone may account for the disparity in the numbers of security deposits, as may some historical factors. However, the proposed new Sale and Supply Code in Victoria will include a new ground for requiring a security deposit from a domestic customer, viz. “having regard to any relevant electricity guideline, the retailer considers the customer has an unsatisfactory credit rating”.

When this new Victorian Code is implemented, there will be a better opportunity for comparison and benchmarking of security deposit numbers and the application of criteria for requiring a security deposit between various electricity retailers in Victoria and South Australia.

In New South Wales, a security deposit may not be required from residential customers unless (among other criteria) the customer does not have a satisfactory credit history with the franchise retailer or cannot demonstrate a satisfactory credit history with another electricity retailer and the franchise retailer has offered the customer an instalment plan and the customer has refused or failed to agree to the offer. In NSW there are currently no publicly available figures which detail and compare electricity retailers with regard to the average size and number of security deposits for different categories of customer.

2.7. Application of criteria for security deposit

The Retail Code provisions set out very limited grounds on which new residential customers can be required to pay a security deposit.

In particular, the Industry Regulator has received legal advice to the effect that “acceptable credit history information” would be interpreted as “objectively acceptable” or “acceptable to a reasonable person” – not “acceptable at the sole discretion of the retailer”.

Acceptable credit history information will include credit history information relevant to **any** credit situation, such as acceptable payment history of any utility accounts, store card accounts, credit card accounts or personal loans. Credit reference from bank or previous landlord, and salary and wages at such a level and lack of other payment obligations such



that the electricity account can be easily accommodated will all demonstrate “acceptable credit history”.

Legal advice received by the Industry Regulator further indicates that it would be a narrow and inaccurate view of “acceptable credit history information” to assert that it only applies to a positive history of paying electricity accounts of a particular kind.

It is also noted in this context that the criteria for requiring a security deposit from a business customer specifically include “satisfactory electricity account payment history”. This criterion does not apply to residential customers except to the extent that an unsatisfactory electricity account payment history may amount to unacceptable credit history information.

In addition, the Retail Code does not allow a retailer to require a residential customer moving to a new supply address to pay a security deposit simply because the customer has a history of paying electricity bills late. The Code requires that the customer must have left a previous supply address without settling an outstanding electricity debt, which remains outstanding, and no arrangements have been made to pay the debt.

In order to be satisfied that the provisions of the Retail Code with respect to security deposits are being adhered to, the Industry Regulator has requested AGL to provide an audit report on AGL SA’s security deposit system. The audit report will focus on the systems, procedures and training that are in place to ensure full compliance with each provision of the Retail Code in relation to security deposits and to identify and rectify areas of non-compliance.

The Industry Regulator notes:

- there will be an opportunity for benchmarking South Australian electricity retailers against Victorian electricity retailers in relation to security deposit matters when the new Victorian Sale and Supply Code is implemented.
- it is the responsibility of AGL to seek security deposits from customers only in compliance with the Retail Code
- AGL has been requested to provide an audit report on its practices in relation to security deposits to satisfy the Industry Regulator that it is complying with the Retail Code (and particularly concerning the application of eligibility criteria and the return of security deposits to consumers).
- Specific information has been sought from AGL as part of the SAIIR compliance monitoring process to ensure it is meeting the Retail Code requirements in relation to requiring and holding security deposits from customers.

2.8. Approval of security deposits

2.8.1. Present level of security deposits

At present the Industry Regulator has approved security deposits of \$100 for both residential and business customers who satisfy the criteria outlined in the Retail Code.

This level of security deposit was approved by State Cabinet in July 1999, and confirmed by the Industry Regulator on 22 March 2000, pending the completion of this review of security deposits and associated issues by the Industry Regulator.

The amount of security deposit which a retailer may require a customer to provide is subject to approval and annual review by the Industry Regulator (see Retail Code: Clause 8.1.1.).

2.9. AGL proposal for Industry Regulator approval

AGL advised the Industry Regulator that it considers the level of security deposits for residential customers is currently appropriate, but that for business customers the level of security deposit is inadequate. A security deposit of \$100 is insufficient security against the typical outstanding debt left by a business customer who is unable to pay electricity bills.

AGL advised that, in 1999/2000, the average security deposit offset against business customer's bad debts was \$206. It should be noted that, prior to the Cabinet decision in July 1999, ETSA Power (as it then was) was able to require security deposits in excess of \$100 from business customers. The average security deposit offset against residential customers' bad debts was \$65.

Clause 8.3.3 of the Retail Code does provide a mechanism for increasing the level of a security deposit where a security deposit is insufficient to secure a business customer's current electricity usage. However, this mechanism may be of little use if, by the time an assessment is made, the customer is not in a position to pay an increased security deposit.

Accordingly, AGL has requested the Industry Regulator to approve an increase in the level of up front security deposits for business customers.

2.10. Proposed decision - Draft Report

The Draft Report proposed approval of the amount of security deposit for AGL customers as follows:

- σ Security Deposit - quarterly billed customer – residential - to remain at \$100.
- σ Security Deposit – quarterly billed customer – business – up to \$300: depending on customer usage level.



- Security Deposit – monthly billed customer – business - up to \$1,500: depending on customer usage level.

No submissions were received on this proposal.

While some concern was expressed in several submissions on the Discussion Paper that any increase in the level of security deposits for business customers would be an impediment to business development and would cause cash flow problems; it is noted that the Retail Code sets out the circumstances in which a retailer can require a customer to pay a security deposit. Whether the retailer chooses to require a security deposit from a customer who could be required to pay such a deposit is a matter for the retailer. However, if a customer falls within a category from which a security deposit can be required, then the retailer is entitled to require that a security deposit be lodged.

The Retail Code does provide flexibility for new business customers who may be faced with the prospect of paying a security deposit. The retailer must accept a bank guarantee from a business customer as an alternative to a cash security deposit. (Retail Code 8.3.2) This is an alternative way for a business customer to meet a security deposit requirement without having to find the requisite amount of cash for a security deposit.

2.11. Consideration of issues

The Industry Regulator has determined the “average quarterly and monthly bill for each category of customer” above.

Applying the formula provided in the Retail Code, the ceiling for security deposits for AGL Retail Code customers on a quarterly billing cycle is 1.5 times the average bill (equating to a maximum security deposit of up to \$303) and for customers on a monthly billing cycle is 2.5 times the average bill (equating to a maximum security deposit of up to \$1,537).

AGL has requested the Industry Regulator’s approval of the amount of security deposits for various categories of customers (as is required by the Retail Code 8.1.1). The amounts requested by AGL are within the ceiling set by the Retail Code, based on the data on average bills provided to the Industry Regulator by AGL.

The Industry Regulator notes that AGL has not requested approval of an increase in the level of security deposit for residential customers.

For business customers, the Industry Regulator accepts that it is reasonable for AGL to assert that the current level of security deposit for business customers is too low and there is a risk of default, particularly from new business customers. Performance monitoring by the Industry Regulator will require AGL to provide detailed reports, on an annual basis, relating

to matters such as the number of security deposits and the amount held for both residential and business customers.

It is noted that once a ceiling dollar amount for security deposits has been established, and the amount has been approved by the Industry Regulator, AGL could choose to “require” that a customer or class of customer meeting the eligibility criteria pay a security deposit at a lower dollar figure or set a security deposit of “up to” those amounts “depending on customer usage level”.

2.12. Final Decision – Amount of security deposit approved for customers of AGL SA

The decision of the Industry Regulator is that the amount of security deposit approved for customers of AGL SA is as follows:

- AGL quarterly billed customer – residential - \$100.
- AGL quarterly billed customer – business - up to \$300
- AGL monthly billed customer – business - up to \$1,500

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3. INTEREST PAID ON SECURITY DEPOSITS

3.1. Retail Code provisions

The Retail Code makes the following provision:

8.4 Interest on Security Deposits

Where a retailer has received a security deposit from a retail code customer, the retailer must pay to the retail code customer interest, if any, on the deposit at a rate and on terms and conditions as approved by the Industry Regulator

3.1.1. Current position

Since October 11 1999, AGL has been paying interest on security deposits at the rate of 0.1% per annum. The Industry Regulator approved this level of interest to be paid on security deposits on 22 March 2000, subject to the completion of this review of security deposits, interest and associated issues.

3.2. Proposed Decision - Draft Report

The Draft Report proposed an increase in the amount of interest payable on security deposits.

In its submission on the Draft Report AGL accepted the determination of the level of interest payable on security deposits. No other submissions were received on this issue.

3.3. Consideration of issues

The Industry Regulator considers the argument for an appropriate amount of interest applied to the security deposit is based on the concept of opportunity cost for the customer, and providing the right incentive for the retailer to only require security deposits where the risk requires it.

The Industry Regulator considers that the following factors should be considered in order to determine an appropriate amount of interest to be applied to security deposits:

- σ The opportunity cost to the customer;
- σ A return no higher than that from a "risk free" investment;
- σ An incentive to the retailer to only seek security deposits where the risk requires it.

The electricity retailer is not in the financial services business, and consequently should not be expected to provide a return comparable to a financial institution. Also, security deposits should not be invested in risky investments (and if they are, due to some internal cash management strategy, then the company should underwrite them). Consequently, returns no



higher than those commensurate with “risk-free” investment should be applied, setting the maximum limit.

However, the customer should expect a return, which as a minimum, should be equal to some benchmarked rate commensurate with minimum risk (eg. cash management account), such that the deposit does not lead to additional indirect expense to the customer.

With regard to providing the right incentive to the retailer, the rate should be set (within the limits described above) such that there is little or no incentive for the retailer to hold on to the cash, simply to earn excess returns from these deposits.

This decision provides for the retailers to continuously make a commercial decision between holding a security deposit on which interest is payable and the risk of the customer defaulting on its account. The judgement/business decision is entirely left to the retailer.

The only issue for the Industry Regulator is to set the amount of interest on security deposits and the terms and conditions on which it should be paid.

In its initial submission, AGL proposed an interest rate of 3.5% being the ANZ Cash Management rate of 5.5% less 2% for administration costs. The Industry Regulator considers that the appropriate discount for investment management and marginal administration costs should be 1%. The interest rate proposed by AGL is considered by the Industry Regulator to be too low and considering the factors listed above, the Industry Regulator makes the following determination:

3.4. Final Decision – Interest paid on security deposits

The decision of the Industry Regulator is:

- The interest rate payable on security deposits under the Retail Code will be the bank bill swap rate for a one (1) year period less 1.0% as reported in the Australian Financial Review Money and Bond Market section on the first Friday of December 2000, and will apply from 1 January 2001*.
- The terms and conditions for the payment of interest are that the interest will be calculated and payable annually (or on a pro-rata basis if the security deposit is returned during any annual period) and must be returned to the customer in accordance with the Retail Code clauses 8.5 and 8.7.

Note: The bank bill swap rate is normally calculated quarterly in arrears and payable at one-quarter of the stated rate. However, in this instance it will be regarded as an annual rate, and a pro-rata system will apply for shorter periods.

* The bank bill swap rate listed in the Money and Bond Market Section of the Australian Financial Review on Friday 1 December 2000 was 6.12%

4. INTEREST CHARGED ON LATE PAYMENTS

4.1. Retail Code provisions

The Retail Code provides:

6.3.3 Particulars on each bill

A retailer must include at least the following particulars on each bill:

...

(n) the amount of interest approved by the Industry Regulator for late payment

...

Customer Sale Contract

11.3 Late payments

If you do not pay your bill on time, we may require you to pay our reasonable costs of recovering that amount from you. You may also be required to pay interest on the outstanding amounts as set out in our price list.

7.7.1 Paying by Instalments

A retailer must offer residential customers at least the following payment options:

(o)

*(p) an **interest free** instalment plan or other arrangement under which the residential customer is given more time to pay a bill or pay arrears (including any disconnection or reconnection charges).*

4.2. Current position

At present no interest rate has been approved by the Industry Regulator to apply to late payments. A key issue for this inquiry is to determine such an amount.

A \$5.60 administrative fee for late payment is charged by AGL, and applies to accounts where a written disconnection warning is issued. AGL also charges disconnection/reconnection fees (covering services performed jointly by AGL and ETSA Utilities) of \$49.40 during business hours reconnection and \$68.50 after hours.

The following table outlines the position with respect to interest rates and other charges on late payments in other jurisdictions and with other utilities.



| UTILITY | INTEREST | OTHER CHARGES |
|----------------------------|--|--|
| SA Water | No interest charged. | Late payment fee \$5.50. |
| Origin Energy | No interest charged. | \$16.50 late fee charged after 3 warnings then \$55 disconnection fee. |
| Telstra | No interest charged. | Disconnection is relatively quick as it does not require a site visit and reconnection charges of \$50.00 applies. |
| Integral Energy (NSW) | No interest charged. | \$5.50 reminder fee charged next day after due date. |
| North Power (NSW) | The contract states that they can charge interest from date payment is due at a commercial banking rate plus 2%. | Can recover costs, for domestic customers - \$5.50 reminder fee. |
| Solaris (AGL) Victoria | No interest charged. | No other charges notified. |
| CitiPower (Victoria) | No interest charged. | No other charges notified. |
| TXU Electricity (Victoria) | No interest charged | No late payment fee. Reconnection fee of \$22 applies (not for health care cardholders or pensioners). |

On the basis of the above table, it appears that the practice of charging interest on late payments is relatively rare amongst utilities.

However, the Retail Code provides for such charges and requires the Industry Regulator to approve an amount of interest for late payment.

Late payment interest may prevent abuse of the payment system and minimise cross subsidisation by consumers who pay on time. However, if customers are having great difficulty in paying for their electricity supply, the imposition of late payment interest would be an additional burden. Nevertheless, the Code provides that if a residential customer negotiates an extension of time to pay, late payment interest cannot be charged.

4.3. Industry relationships

AGL and other retailers bill customers on behalf of ETSA Utilities, and interest accrues for late payments made by retailers to ETSA Utilities. This rate is the bank bill rate plus 2%. Under the coordination agreement between the distributor and retailers, the distributor issues a statement of charges no later than the 10th business day after the end of each billing period, and the retailer must pay the amount on the later of the 10th business day after the receipt of the statement of charges or the 15th business day after the end of the billing period.

Under the National Electricity Code, a market participant must pay interest on any unpaid monies and the rate of interest payable is the bank bill rate calculated as simple interest on a daily basis from the date payment was due up to and including the date of payment, with interest compounding monthly on the last day of each month whilst the monies remain outstanding. In the National Electricity Market, final statements must be issued no later than 18 business days after the end of each billing period and payment by market participants must be on the 20th business day after the end of a billing period or 2 business days after receiving an estimated settlement amount.

In general, therefore, AGL incurs late payment interest on accounts after about 15 to 20 days from the end of a billing period, or 2 to 10 days after receipt of the account.

4.4. Proposed Decision – Draft Report

The Draft Report proposed that the interest allowed on late payments be the bank bill swap rate plus 1%.

In its initial submission AGL put forward the view, that for business customers, the supply of electricity should be treated no differently from the supply of any other service and that late payment should attract an appropriately discouraging level of interest. In addition, it is noted that late payments impose a cost burden on the electricity retailer that ultimately must be borne by all consumers through higher prices. AGL proposed a rate of approximately 13.00% for late payment interest (being the ANZ retail index rate plus 3%).

In a submission on the Draft Report, AGL argued that the interest rate should be high enough to deter late payment of electricity bills. AGL considered that a penalty of 2% should be added to the proposed amount for late payment interest.

No other submissions were received on this issue.

4.5. Consideration of issues

In determining the interest charge on late account payments, the Industry Regulator has applied the same argument as with security deposit interest. That is, the amount of interest that retailers should be able to charge on late payment should be equal to the retailers' opportunity cost, just as the rate set for security deposits was the consumer's opportunity cost of what it could earn on the money in a short term low risk investment.

This amount is determined by evaluating the amount paid by the retailer to its supplier, for any overdue amounts. AGL SA currently pays ETSA Utilities the bank bill rate plus 2% on late payments, and the amount payable to NEMMCO for any overdue amounts is the bank bill rate. A weighted average would suggest the cost to AGL is presently below 7.0%.



Therefore, it is considered that it is reasonable for AGL to recover this amount of interest from its business customers, for payments delayed beyond the stated payment date.

AGL indicated that in the 6 months September 1999 – February 2000, almost 5,000 business customers had not paid their account within 31 business days of the account being sent (the Retail Code allows for a pay by date to be not less than 12 business days after the retailer sends the bill). By this stage the customer has received the original account, a reminder notice, and a final notice. This figure does not include the number of business customers who request (and are granted) extension of time to pay. It takes approximately 30 business days (or six weeks) from the issue of a bill to the issue of a disconnection notice. AGL's proposal is that late payment interest apply to amounts not paid by the expiry of the due date in the reminder notice, and that interest will apply from the last day to pay shown on the original account.

The Industry Regulator notes that AGL is under an obligation to pay interest on late payments in the electricity supply industry at 15 –20 business days from the end of a billing cycle, or 2 – 10 days after receipt of the account, and considers that AGL's proposals relating to the application of late payment interest compare appropriately with AGL's own commercial obligations to pay interest.

In its submission on the draft Report, AGL disagreed with the view of the Industry Regulator that the amount of interest should be based on the retailer's opportunity cost, arguing instead that the cost should be a deterrent cost. That is, the interest rate should be so high as to deter late payment of electricity bills. AGL considered that a penalty of 2% should be added to the proposed amount for late payment interest.

The Industry Regulator notes that there is presently no interest payable on late payments of electricity accounts by business customers. It is therefore possible that the simple application of an amount of interest for late payment will in itself be a deterrent to late payments.

Given that there is currently no late payment interest, the Industry Regulator considers that AGL is not presently in a position to assert that a penalty interest rate is required to deter late payments. With the approval of the Industry Regulator of an amount of late payment interest, AGL will be in a position over the next year to monitor and collect data on the effect of such interest on the bill paying habits of business consumers, and to present evidence at the next review in support of a penalty rate if the approved rate has not had the desired impact.

The Industry Regulator notes that AGL does not intend to apply late payment interest to residential customers. For the domestic consumer (particularly those who are genuinely

struggling to pay their bills as a result of financial circumstances), it is noted that the Retail Code specifically provides in Clause 7.7.1 that a retailer must offer a residential customer the option of an interest free instalment plan or other arrangement under which the customer is given more time to pay a bill or arrears (including any disconnection or reconnection charges).

4.6. Final Decision – Interest charged on late payments

The decision of the Industry Regulator is that:

- the bank bill swap rate for a one (1) year period plus 1% (as reported in the Australian Financial Review Money and Bond Market Section on the first Friday in December 2000*), will be the approved amount of annual interest on late payments of electricity accounts, to apply from 1 January 2001.
- no additional amount of penalty interest is approved.

The Retail Code does not presently provide for the Industry Regulator to set terms and conditions relating to the application of late payment interest. This matter will be considered when the Retail Code is reviewed. However, it is noted that AGL has indicated it will:

- apply the charge only for business customers consuming more than 30MWh per annum;
- apply the charge from due date if payment is not received by the pay by date in the reminder notice; and
- not apply the charge to payments where there are mutually agreed extensions of time to pay.

* The bank bill swap rate listed in the Money and Bond Market Section of the Australian Financial Review on Friday 1 December 2000 was 6.12%

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5. PRE-OCTOBER 11 LICENSED RETAILERS

5.1. Licences issued prior to 11 October 1999

While AGL holds a licence issued by the Industry Regulator to which the Retail Code applies, there are a number of other retail electricity licences that were issued by the Technical Regulator prior to the Electricity Act being significantly amended on 11 October 1999.

These other retail licences remain valid and are now being administered by the Industry Regulator. These licences contain a condition that the licensees comply with a retail code attached to the licence. The applicable code has slightly different provisions with regards to the amount of and the circumstances in which a security deposit can be required.

5.2. Applicable Retail Code provisions

Clause 9 of the applicable code provides:

9. Refundable Advances and Alternatives

Refundable Advances

- 9.1 *Subject to clause 9.3 the Licensee may require a customer to provide a refundable advance before the commencement of supply.*
- 9.2 *Subject to approval and annual review by the Technical Regulator the amount of refundable advance must be not more than 1.5 times the average quarterly bill.*
- 9.3 *The Licensee must not require a customer to provide a refundable advance before the commencement of supply unless:*
 - 9.3.1 *the customer has left a previous supply address without settling an outstanding electricity usage debt, the debt remains outstanding and the customer refuses to make an arrangement to repay it; or*
 - 9.3.2 *the customer has within the previous 2 years been responsible for the illegal use of electricity; or*
 - 9.3.3 *the customer is a new customer and has refused to supply acceptable identification, or*
 - 9.3.4 *the Licensee has, in accordance with clause 8 offered the customer an instalment plan or other payment option and the customer has refused or failed to agree to the offer.*



Interest on Refundable Advances

9.4 *If the Licensee has received a refundable advance for a customer, the Licensee must pay to the customer interest on the advance at the rate from time to time of the Prime Rate of the Bank of South Australia.*

Return of the Refundable Advance

9.5 *If a customer is required by the Licensee to pay a refundable advance, the Licensee must, within 10 days of a customer completing one year's payment of the customer's billing cycle by the pay by dates on the initial bill [inform the customer of the amount of the advance and interest....and pay the amount in accordance with the customer's instructions].*

5.3. Security Deposit and Interest Rules – Pre October 11 Licences

A pre-October 11 licensee is not able to claim a security deposit from every customer, and there is to be an approval and annual review of the amount of the refundable advance. Interest must be added to the refundable advance and the advance must be repaid after one year of satisfactory payment.

The applicable code makes no provision for late payment interest.

5.4. Non-compliance with the applicable Retail Code

The Industry Regulator is aware of instances where the pre October 11 retail code has not been complied with by those retailers to which it applies as part of the licence. The main non-compliance is in the following areas:

- imposition of requirements that all new and transferring customers lodge a security deposit. (This is regardless of credit history or satisfactory payment history, and despite the fact that the applicable code only permits a retailer to require a security deposit from a customer who refuses to supply acceptable identification).
- imposing security deposits which have not been approved and which do not meet the applicable retail code test of being no greater than 1.5 times greater than the average quarterly bill.
- non-payment of interest on security deposits (the relevant interest rate which should be applied is the BankSA Prime Rate – this rate is currently 9.9%).
- not returning a security deposit after one year of satisfactory account payments.

5.5. Proposed Decision – Draft Report

The Draft Report proposed a series of changes to the licence conditions applying to pre-October 11 retailers.

Submissions were received from 3 of these retailers. All supported the proposals contained in the Draft Report. One submission suggested there had not been sufficient consultation with the consumers of electricity in the areas provided with electricity supply by these retailers.

5.6. Consideration of issues

The issues surrounding pre-October 11 licences issued by the Technical Regulator and the applicable retail code provisions are canvassed in more detail in a Discussion Paper: **Review of Licences and Exemptions Issued prior to October 11 pursuant to the Electricity Act**, issued by the Industry Regulator in June 2000 (copy available from www.sair.sa.gov.au or from the SAIR Office). The Industry Regulator is currently discussing proposals to vary these licences with the individual retailers concerned. The approach to the issues concerning security deposits, interest on security deposits and late payment interest will be in accordance with the determinations in this Report.

It is the view of the Industry Regulator that all retailers should be bound by the same basic rules in relation to the retailing of electricity, and that the Retail Code under the IIR Act should, as far as is practicable, apply to all retailers.

The Industry Regulator accepts, however, that there are some peculiar circumstances applying to pre-11 October licensed electricity retailers:

- σ Some are non-profit organisations;
- σ Some service highly itinerant populations;
- σ Bad debtors do not generally seek re-supply from the same retailer;
- σ Higher tariffs mean larger bills, so higher security deposits are required; and
- σ Remoteness (and higher average temperatures) means that average electricity bills tend to be higher than in grid-connected areas.

The Industry Regulator considers that the issues raised by remote and off-grid retailers can be addressed in four ways.

First, these retailers should be permitted to require a security deposit from a broader range of customers. At present these retailers can require security deposits only from those new customers who refuse to provide acceptable identification. This does not permit a credit assessment of a potential customer. It is proposed that the licences be amended to allow a retailer to require a customer who is unable to show a satisfactory history of paying electricity accounts with the retailer to pay a security deposit before connection of supply. This is a narrower credit test than that applied for metropolitan and rural on-grid customers, but should address the concerns of remote retailers.



Second, the licences should be amended to provide that the amount of security deposit would be approved by the Industry Regulator and be either:

- σ not more than 1.5x average quarterly and 2.5x average monthly bills for different categories of customer. Retailers would need to supply the Industry Regulator with details of the average bills and a proposal for amount(s) of security deposit together with a justification for the proposed amounts, within the limits set by the Retail Code; or
- σ the amount of security deposit approved for customers of AGL SA.

Third, the licences should be amended to permit these licensed retailers to hold security deposits for up to 2 years' of good payment performance (instead of the current 1 year). A customer would be paid interest at the annual rate approved by the Industry Regulator (see section 3.3, above) on the deposit for the time for which it is held. As indicated above the interest rate which licensees should currently be applying is 9.9% per annum. The interest rate proposed to be approved by the Industry Regulator is the bank bill swap rate less 1%. The implementation of this recommendation should result in a saving for all pre October 11 licensees. All retailers would be required to pay interest at the appropriate rate, and retailers would be in a position of having to make a commercial decision between requiring a security deposit upon which interest is payable, and the risk of the customer defaulting on its account.

It is considered that if a deposit is held for 2 years, and a customer establishes a satisfactory payment history in that time, the deposit should then be returned.

The Regulator intends to review experiences with this proposal to determine whether a shorter (or longer) period for holding a security deposit should apply and whether the credit history information proposals are appropriate. Retailers will need to keep records that will assist in this review process.

Fourth, these retailers should be given the ability to charge late payment interest (at the appropriate rate: see section 4.5, above). However, there would be no compulsion to charge this interest. The rate of interest would be that approved by the Industry Regulator.

5.7. Final Decision – Pre-11 October licensed retailers

The Industry Regulator determines:

- All retailers should be bound by the same basic rules in relation to the retailing of electricity in South Australia, and so far as possible the Retail Code should apply to all retailers.

The Industry Regulator proposes that pre-October 11 licences be varied in the following manner:

- Licensees should be permitted to require an approved security deposit from customers who are not able to demonstrate a satisfactory history of paying electricity accounts with the licensee, and to hold the security deposit for a period of up to 2 years good payment behaviour by the consumer.
- The interest rate payable on security deposits will be approved by the Industry Regulator and will be the bank bill swap rate for a one (1) year period less 1.0% as reported in the Australian Financial Review Money and Bond Market section on the first Friday of December 2000* (It is noted that it will be mandatory for a licensee to add interest to security deposits).
- Licensees should be permitted to apply late payment interest as approved by the Industry Regulator and the rate will be the bank bill swap rate for a one (1) year period plus 1% (as reported in the Australian Financial Review Money and Bond Market Section on the first Friday in December 2000*), as the amount of annual interest on late payments of electricity accounts. (It is noted that it will not be mandatory for a licensee to charge interest on late payments).
- The above determinations of the Industry Regulator will apply from the date that pre-October 11 licences are varied.
- The maximum security deposit which a licensee can require will be either:
 - not more than 1.5x the average quarterly and 2.5x the average monthly bill for different categories of customers as provided for in the Retail Code. Retailers holding pre-October 11 licences will need to provide details to the IndustryRegulator of the average quarterly and monthly bills, and seek the Industry Regulator's approval of amounts proposed as security deposits, which amounts must be within the ceiling provided for in the Retail Code; or
 - the amount of security deposit approved for customers of AGL SA.
- Specific information will be sought from retailers as part of the SAIR performance monitoring process to ensure retailers are meeting the requirements of the Retail Code in relation to requiring security deposits from customers.

* The bank bill swap rate listed in the Money and Bond Market Section of the Australian Financial Review on Friday 1 December 2000 was 6.12%

6. DISPUTE RESOLUTION

6.1. Retail Code requirements – Internal dispute resolution

The Retail Code requires each retailer to have clear and approved processes for handling and resolving customer complaints and disputes, including disputes about security deposits and interest payments. The processes must deal with matters such as how the customer can make a complaint, how complaints will be handled, response time for complaints, method of response, and detail the procedure to be followed if the complaint cannot be satisfactorily resolved.

The Industry Regulator reviewed, revised and approved the dispute resolution procedures established by AGL in December 1999.

6.2. Electricity Ombudsman Scheme

The Electricity Industry Ombudsman (EIO) Scheme offers electricity consumers a fast, simple, fair, informal, no-cost avenue for the resolution of disputes and complaints which have been unable to be resolved through internal mechanisms described above.

The Electricity Industry Ombudsman has specific power to receive, investigate and facilitate the resolution of the administration of credit and payment services and disconnection and security deposit complaints.

At present membership of the EIO Scheme is not a requirement of the pre-October 11 licences. This means that consumers of electricity from these licensees do not have access to an external dispute resolution service, except to the extent that the State Ombudsman may be able to handle such complaints. This matter will be considered further by the Industry Regulator, in the context of the Review of Pre-October 11 Licences, referred to in section 5, above.

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7. OTHER MATTERS

7.1. Approval and annual review of level of security deposits

The Retail Code provides that the level of security deposit is subject to approval and annual review of the Industry Regulator.

Should AGL or a pre-October 11 licensed retailer wish to change the level of security deposit for the year 2002, submissions for the approval of the Industry Regulator must be provided to the SAIR office no later than 1 October 2001. This will allow sufficient time for the Industry Regulator to consider the proposals and to undertake appropriate consultation.

7.2. Review of Retail Code

The Retail Code will need to be reviewed prior to the introduction of Full Retail contestability in South Australia from 1 January 2003.

The Industry Regulator will review the Retail Code, including the provisions relating to security deposits, interest on security deposits and late payment interest, prior to that time.

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8. APPENDIX A - SUBMISSIONS

The Public Discussion Paper and Draft Report were sent to:

- σ All holders of retail electricity licences, including the holders of pre-October 11 licences
- σ All interstate utility regulators
- σ All Members of the South Australian Parliament
- σ All members of the Consumer Advisory Committee
- σ Australian Retailers Association
- σ Business SA
- σ Conservation Council of SA
- σ Consumers Association of SA
- σ Division of State Aboriginal Affairs
- σ ETSA Utilities
- σ Local Government Association
- σ Property Council of Australia, SA Branch
- σ SA Council on the Ageing
- σ SA Council for Social Services
- σ SA Gas and Electricity Users Group
- σ South Australian Farmers Federation
- σ State Retailers Association

Submissions on the Public Discussion Paper were received from:

- σ AGL South Australia Pty Ltd
- σ The ATCO Group
- σ Business SA
- σ Cowell Electric Supply Co Ltd
- σ Dalfoam Pty Ltd
- σ District Council of Coober Pedy
- σ Office of the Regulator General (Vic)
- σ Roxby Downs Council
- σ South Australian Farmer's Federation
- σ State Retailers Association
- σ Ms Lea Stevens MP

Submissions on the Draft Report were received from:

- σ AGL SA
- σ Conservation Council of SA
- σ Minister for Consumer Affairs
- σ Cowell Electric Supply Co.
- σ District Council of Coober Pedy
- σ Electricity Industry Ombudsman
- σ Roxby Downs Council
- σ The Treasurer