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Via online submission

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
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Dear Mr Pierce

Rule change proposal—Retailer insolvency costs and pass through arrangements – National Gas Rules

The market considered retailer insolvency issues as part of the National Energy Consumer Framework (**NECF**) reforms in 2012. This resulted in new rules relating to retailer insolvency being inserted into the National Electricity Rules (**NER**) and National Gas Rules (**NGR**).

However, the final rule drafting was not fully consistent with the Council of Australian Governments (**COAG**) Energy Council's policy on this issue. In October 2014 the COAG Energy Council proposed a rule change to the NER to ensure the NER properly reflected its policy position. However, despite the clear policy position, no equivalent change was proposed to the NGR.

Our rule change proposal seeks to align the NGR to the COAG Energy Council's policy intent. The rule change is proposed at this time to allow it to be considered with the open rule changes relating to retailer insolvency events and credit support.

The key benefit of the proposed rule change is to make it clear that gas distributor may recover unpaid distribution charges where a retailer becomes insolvent. This additional clarity will eliminate any doubt that, where a retailer becomes insolvent, a gas distributor will not be left bearing the financial consequences of this insolvency.

Making the rule would give confidence to customers—as well as gas distributors and their financial backers—about the risk exposure of gas distributors if a retailer was to become insolvent. It also mitigates (and potentially eliminates) the costs associated with gas distributors bearing this risk themselves, or paying a third party to bear this risk. This puts downward pressure on customers' upfront network tariffs.

If you wish to discuss our proposal please contact me on (03) 8544 9000 or at robert.mcmillan@jemena.com.au.

Yours sincerely

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General Manager Regulation
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Jemena Gas Networks (NSW) Ltd

Rule change proposal - National Gas Rules

Retailer insolvency costs and pass through arrangements

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1. INTRODUCTION AND SUMMARY

1. Jemena Gas Networks (NSW) Ltd (**JGN**) is the owner and operator of the NSW Gas Network.[1] We are seeking a rule change to the National Gas Rules (**NGR**) to ensure that appropriate and clear pass through arrangements are provided for gas distributors in the event of a retailer insolvency event.

2. Our rule change proposal seeks to align the NGR to the Council of Australian Governments (**COAG**) Energy Council's[2] **COAG** policy intent. The rule change is proposed at this time to allow it to be considered with the open rule changes relating to retailer insolvency events and credit support.[3]

1.1 BACKGROUND

3. The market considered retailer insolvency issues as part the National Energy Consumer Framework (**NECF**) reforms in 2012. This resulted in new rules related to retailer insolvency being inserted into the National Electricity Rules (**NER**) and NGR.

4. However, the final rule drafting was not fully consistent with the COAG Energy Council's policy on this issue. In October 2014 the COAG Energy Council proposed a rule change to the NER to ensure the NER properly reflected its policy position. However, despite the clear policy position, no equivalent change was proposed to the NGR.

5. The Australian Energy Market Commission (**AEMC**) has since consolidated the COAG Energy Council's NER rule change with another NER and NGR rule change on credit support raised by AGL.[4] This allows the AEMC to consider the two related issues together.

6. JGN would support the further consolidation of its own rule change proposal with the current credit support rule changes to enable efficient consideration by the AEMC, industry, customers and other stakeholders.

1.2 RULE MAKING REQUIREMENTS

7. JGN understands that the AEMC may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the National Gas Objective (**NGO**)[5] as set out in section 23 of the National Gas Law (**NGL**):

> *'The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.'*

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1 The Network consists of the NSW Distribution System, the Wilton-Newcastle trunk pipeline, the Wilton-Wollongong trunk pipeline and the Central West Distribution System.

2 The COAG Energy Council was formerly the Standing Council on Energy and Resources (SCER).

3 AEMC, ERC0172, 'Retailer Insolvency costs – pass through provisions', raised by COAG Energy Council. The AEMC consolidated this rule change with AGL's retailer-distributor credit support requirements rule change proposal—AEMC, ERC0183 and GRC032 'Retailer-Distributor Credit Support Arrangements', initiated 28 May 2015.

4 AEMC, ERC0183 and GRC032 'Retailer-Distributor Credit Support Arrangements', initiated 28 May 2015.

5 Section 291 of the NGL.

8. JGN also understands that any proposal for the making of such a rule must address the specific matters set out in clause 13 of the National Gas (South Australia) Regulations (**Regulations**), including setting out the expected benefits and costs of this proposed rule change and the potential impacts it may have on other parties.

1.3 STRUCTURE OF THE PROPOSAL

9. In keeping with the requirements set out in the NGL and clause 13 of the Regulations, the remainder of this rule change proposal is structured as follows:

- Chapter 2 outlines the nature and scope of the issue that this rule change proposal is designed to address
- Chapter 3 explains how this proposed rule change will, or is likely to, contribute to the achievement of the NGO and sets out the expected benefits and costs of this proposed rule change and the potential impacts it may have on other parties
- Chapter 4 contains a description of this proposed rule change and sets out the proposed draft rules.

2. STATEMENT OF ISSUE

2.1 POLICY POSITION

10. The industry considered retailer insolvency risks as part of incorporating the NECF into the NER and the NGR in 2012. In this regard, the policy of the COAG Energy Council is clear, in that:

- distributors should be able to recover distribution charges, as the nature of regulated pricing means that distributors cannot adjust their prices or vary credit support arrangements to reflect the risk of retailer default in payment of distribution charges
- where revenue cannot be recovered from the relevant retailer, including by accessing credit support arrangements, unpaid distribution charges can be recovered from the applicable distributor's customer base
- no materiality threshold should apply to retailer insolvency events.[6]

11. As a consequence, new provisions were inserted into the NER and NGR. However, the final rule drafting was not consistent with the COAG Energy Council's policy, in that the rules as currently drafted permit cost pass through recovery of costs incurred as a result of retailer insolvency, but it is not explicit that they extend to cover unpaid distribution charges (i.e. foregone revenue).[7]

2.2 COAG NER RULE CHANGE PROPOSAL

12. As a consequence, the COAG Energy Council proposed a rule change to the NER in October 2014 to ensure alignment between the policy and rules. COAG's rule change proposal details the rationale for this position.

13. JGN considers that the arrangements for gas distributors and electricity distribution network service providers (**DNSPs**) are sufficiently similar for comparable pass through rules to apply. In particular, like electricity DNSPs, gas distributors:

- are required to offer customer connections services (both have to offer anyone a connection)
- have no ability to make fully independent decisions to manage the risk of counter party default.

14. However, despite COAG's clear policy position in electricity and the comparable arrangements in gas, no equivalent rule change was proposed to the NGR at that time.

2.3 JGN RULE CHANGE PROPOSAL

15. To rectify this issue, JGN's rule change proposal amends NGR rule 531 to:

- clarify that the amounts to be passed through cover both the cost impacts of retailer insolvency, as well as amounts that a gas distributor is entitled to be paid, but which are or will be unpaid as a result of a retailer insolvency event

[6] COAG, Rule change request 'Retailer Insolvency costs – pass through provisions' Rule change (March 2014), initiated by AEMC 30 Oct 2014.

[7] NGR, rule 531.

- if a retailer insolvency event occurs, the resulting AER-determined cost pass through amount will be reflected in tariffs via the tariff variation mechanism in the relevant gas distributor's access arrangement - even if the access arrangement itself does not provide for this at present, or contains provisions that are not consistent with, or operate in a different way to, this mechanism (for example, where the access arrangement currently provides for cost pass through in the case of retailer insolvency, but that unlike rule 531 NGR, this is subject to the 1% smoothed revenue materiality threshold being met).

  A new sub-rule 531(4) is proposed to address this issue. JGN has framed sub-rule (4) having regard to the wording of s167(4)(b) of the National Energy Retail Rules, which also addresses the issue of statutory cost pass through operating alongside gas distributors' access arrangements – in that particular case dealing with distributor cost pass through where a RoLR cost recovery scheme is applicable.

16. The above changes have been framed to align, where practicable, with the position taken in relation to the NER by the COAG Energy Council (but recognising there are some drafting differences between NGR rule 531 and the equivalent provisions in the NER). At this point, it should be noted that COAG's proposal also seeks amendments to remove the current NER requirement for a retailer insolvency event to meet the materiality threshold (as defined in the NER). This issue does not arise in the case of the NGR, as—consistent with the policy position—cost pass through relief for retailer insolvency events is not subject to any materiality threshold requirement.

17. Finally, JGN notes that its rule change proposal is not seeking cost pass through as an alternative to appropriate credit support arrangements developed by the AEMC under the current credit support rule change (GRC032). This proposal does not seek amendment to the existing provisions in rule 531 that exclude from the pass through any amount recoverable via credit support or the retailer of last resort recovery scheme,[8] and likewise does not seek any amendment to the NGR definition of "retailer insolvency event" itself.

[8] NGR, rule 531(3).

3. CONSISTENCY OF THIS PROPOSED RULE CHANGE WITH THE NGO AND EXPECTED COSTS AND BENEFITS

18. The main purpose of the rule change is simply to rectify an error in implementing settled policy. To this extent, the NGO test has already been applied and satisfied. However, in keeping with the rule making requirements set out in the NGL, we have still assessed whether our proposed rule change will, or is likely to, contribute to the achievement of the NGO.

19. The key findings of this assessment are set out below.

3.1 BENEFITS AND COSTS

20. The key benefit of the proposed rule change is to make it clear that gas distributors may recover unpaid distribution charges where a retailer becomes insolvent. Under rule 531 at present, a distributor may qualify for cost pass through relief in relation to costs incurred arising from retailer insolvency (subject to the qualifications set out in the rule), but as the rule refers to “costs” there is uncertainty as to whether this relief extends to foregone revenue—contrary to the clear policy position.

    This additional clarity as to the distributors’ ability to recoup unpaid distribution charges in a retailer insolvency context will eliminate any doubt that, where a retailer becomes insolvent, a distributor will be left bearing the financial consequences of this insolvency. Making the rule would give confidence to customers—as well as gas distributors and their financial backers—about the risk exposure of gas distributors if a retailer was to become insolvent. It also mitigates (and potentially eliminates) the costs associated with gas distributors bearing this risk themselves, or paying a third party to bear this risk. This puts downward pressure on customers’ upfront network tariffs.

21. This is in keeping with the general regulatory framework set out in Parts 8-10 of the NGR, which aims to ensure that network revenues cover the efficient costs of providing reference services.

22. If JGN’s rule change proposal is accepted, additional costs for customers would only be realised where a retailer insolvency event occurs, there are foregone distribution charges as a result of the event, and those distributor’s distribution charges cannot be recovered from the credit support arrangements. In these instances, the pass through mechanism would result in temporarily higher network tariffs. Because of the likely infrequency of retailer insolvency events and the protections in the NGR, we consider any temporarily higher tariffs would be more than offset by having lower upfront network tariffs at all other times.

3.2 POTENTIAL IMPACTS ON AFFECTED PARTIES

23. JGN expects the proposed rule change to have a positive impact on JGN’s network users, retail gas customers and customers in other downstream markets because the certainty will help ensure the long-term average of tariffs is lower when compared to the counterfactual.

24. In the event a positive pass through is required following a retailer insolvency, customers would face temporarily higher tariffs for the year, or years, in which the pass through applies. However, given the rule change is seeking to clarify the NGR and align with policy intent, JGN considers this outcome is likely to also occur under the counterfactual of the current rules.

3.3 DISCUSSIONS IN DEVELOPING THE PROPOSAL

25. JGN has engaged with other gas distributors as part of developing the proposed rule change and received support. We also heard distributor support for the rule to be applied in Victoria, where NGR rule 531 does not currently apply given NECF has not commenced there. The AEMC may wish to consider this further to enable the rule to be applied consistently across jurisdictions.[9]

[9] A potential approach suggested to JGN could, for example, be to remove Rule 531 in its entirety and making a new Rule 531 with the amendments proposed.

4. PROPOSED RULE

26. A track change version showing JGN's proposed amendments to NGR rule 531 is set out below.

531 Pass through of unpaid distribution service charges

(1) If a *retailer insolvency event* occurs, a *distributor* may apply to the AER for approval to vary one or more reference tariffs by a *retailer* insolvency pass through amount in accordance with this rule.

(2) To apply for approval to vary a reference tariff under subrule (1), a *distributor* must submit to the AER, within 90 business days of the occurrence of a *retailer insolvency event*, a written statement including:

(a) the *distributor's* proposed *retailer* insolvency pass through amount, showing the calculation of that amount taking into account the matters in subrule (3); and

(b) the portion of that amount that the *distributor* proposes to pass through to end users in each year of the applicable *access arrangement period* and how each reference tariff would be varied to achieve that pass through; and

(c) evidence of:

(i) the actual and likely increase in costs referred to in subrule (3)(a);

(ii) the actual and likely unpaid amounts referred to in subrule (3)(b); and

(ii) the amount to which the *distributor* is entitled under any relevant *credit support*; and

(iii) the maximum amount of *credit support* (if any) that the *distributor* was entitled to request the *retailer* to provide under the *credit support* rules; and

(iv) any amount that the *distributor* is likely to receive on a winding-up of the *retailer*.

(3) The *distributor* must propose, and the AER must determine, a *retailer* insolvency pass through amount that reflects both:

(a) the increase in the costs of providing reference services that the *distributor* has incurred and is likely to incur until the end of the applicable *access arrangement period* solely as a consequence of the *retailer insolvency event*; and

(b) any amounts a *distributor* is entitled to be paid for the provision of reference services, but which are or will be unpaid as a result of the *retailer insolvency event*, including the amount of revenue impact the *distributor* sustains or will sustain as a result of those amounts not being paid to it,

but does not include:

(c) any amount recovered or recoverable from a *retailer* or guarantor of a *retailer* under this Part; or

(d) any costs that are recoverable under a *RoLR cost recovery scheme distributor payment determination*.

(4) In the event that a *retailer insolvency event* has occurred and the AER approves a *retailer* insolvency pass through amount under subrule (3) in respect of that event, the *distributor's* access arrangement is taken to be amended so that:

(a) the *retailer insolvency event* is taken to be an approved cost pass through event under that access arrangement; and

(b) the *retailer* insolvency pass through amount determined under subrule (3) is taken to be an approved cost pass through amount under that access arrangement, allowing variation of the *distributor's* reference tariffs.

(5) In this rule:

retailer insolvency event means the failure of a *retailer* during an *access arrangement period*, to pay a *distributor* an amount to which the service provider is entitled for the provision of reference services, if:

(a) an *insolvency official* has been appointed in respect of that *retailer*; and

(b) the *distributor* is not entitled to payment of those charges in full under the terms of any *credit support* provided in respect of that *retailer*.

RoLR cost recovery scheme distributor payment determination has the same meaning as in the *NERL*.