Joint Implementation Group

National Energy Customer Framework

Implementation issue No.0001

Retailer insolvency event and pass through

The Joint Implementation Group (JIG) is co-ordinating the implementation of the National Energy Customer Framework (NECF) by participating jurisdictions. This note provides information in response to a request by electricity distributors (via the Energy Networks Association) for clarification of the drafting in the *National Electricity (Retail Support) Amendment Rules 2010* relating to cost pass through for retailer insolvency events.

Policy rationale

The policy rationale for the retailer insolvency pass-through is an economic one. Distributors are unable to manage the risk of retailers defaulting on payment of their network charges (due to the regulated credit support regime, and the obligation to supply distribution services to all retailers). Therefore, any amount they cannot otherwise recover (by drawing on credit support or by recourse to other commercial law recovery options) should be passed through to customers.

The reason for not applying a materiality threshold here is that the presence of a materiality threshold is part of the incentive regulatory regime. It acts to incentivise distributors to manage the costs of events that aren't forecast but arise through the normal course of doing business in the energy sector. Distributors have no ability (again, for the reasons above) to manage the 'costs' of unpaid network charges. So the policy position is that no materiality threshold applies.

The costs of managing a RoLR event itself are something that a distributor can manage and minimise through operational efficiency. So any costs associated with the *handling* of a RoLR event should be subject to the normal pass through regime and be subject to a materiality requirement. This is the status quo for these costs.

Rationale for proposed alterations

The current drafting reflected in the *National Electricity (Retail Support) Amendment Rules 2010* was agreed as outlined above. However, distributors identified a problem with the rules. By fitting a revenue impact into a cost-based pass-through regime (deeming the revenue impact to be a cost), distributors consider the drafting didn't quite resolve the issue because the NER pass-through regime allows only costs "that increase the costs of providing direct control services" to be passed through. Distributors considered it was still quite unclear whether the revenue impact-cum-cost would clear this hurdle. This is the problem the drafting below is seeking to resolve.

Proposed changes to rules

The following is a mark up of relevant definitions and clause 6.6.1 of the National Electricity Rules. The red text denotes changes made in the current proposed amendments in the *National Electricity (Retail Support) Amendment Rules 2010* (not yet made). The blue text denotes the further proposed clarifications to the drafting.

pass through event

Any of the following is a *pass through event*:

(a) a regulatory change event;

(b) a service standard event;

(c) a tax change event;

(d) a terrorism event;

(e) for a transmission determination, an insurance event;

(f) for a distribution determination:

  (1) a *retailer insolvency event*;

  (2) any other event nominated in the distribution determination as a *pass through event*.

positive change event

(a) For a *Transmission Network Service Provider*, a *pass through event* that *materially* increases the costs of providing *prescribed transmission services*, but does not include a *contingent project* or an associated *trigger event.*

(b) For a *Distribution Network Service Provider*, a *pass through event* that *materially* increases the costs of providing *direct control services*.

(c) For a *Distribution Network Service Provider*, a *retailer insolvency event*. ~~that increases the~~ ~~costs~~ ~~of the *Distribution Network Service Provider*.~~ ~~providing *direct control services*.~~

retailer insolvency costs
Amounts a *Distribution Network Service Provider* is entitled to be paid (but which are or will be unpaid as a result of a *retailer insolvency event*) for the provision of *direct control services* including the revenue impact a *Distribution Network Service Provider* sustains or will sustain as a result of those unpaid amounts.

retailer insolvency event
The failure of a *retailer* during a *regulatory control period,* to pay a *Distribution Network Service Provider* an amount to which the service provider is entitled for the provision of *direct control services,* if:

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

(b) the *Distribution Network Service Provider* is not entitled to payment of ~~those charges~~ that amount in full under the terms of any *credit support* provided in respect of that *retailer*.

Chapter 6 NER

6.6.1 Cost pass through

(a) If a *positive change event* occurs, a *Distribution Network Service Provider* may seek the approval of the *AER* to pass through to *Distribution Network Users* a *positive pass through amount*.

(b) If a *negative change event* occurs, the *AER* may require the *Distribution Network Service Provider* to pass through to *Distribution Network Users* a *negative pass through amount* as determined by the *AER* under paragraph (g).

Positive pass through

(c) To seek the approval of the *AER* to pass through a *positive pass through amount*, a *Distribution Network Service Provider* must submit to the *AER*, within 90 *business days* of the relevant *positive change event* occurring, a written statement which specifies:

(1) the details of the *positive change event*; and

(2) the date on which the *positive change event* occurred; and

(3) the *eligible pass through amount* in respect of that *positive change event*; and

(4) the *positive pass through amount* the provider proposes in relation to the *positive change event*; and

(5) the amount of the *positive pass through amount* that the provider proposes should be passed through to *Distribution Network Users* in each *regulatory year* during the *regulatory control period*; and

(6) evidence:

(i) of the actual and likely increase in costs referred to in subparagraph (3); and

(ii) that such costs occur solely as a consequence of the *positive change event*; and

(iii) in relation to a *retailer insolvency event*, of :

(A) the amount to which the *Distribution Network Service Provider* is entitled under any relevant *credit support*; and

(B) the maximum amount of *credit support* (if any) that the *Distribution Network Service Provider* was entitled to request the *retailer* to provide under the *credit support* rules; and

(C) any amount that the *Distribution Network Service Provider* is likely to receive on a winding-up of the *retailer*.

(7) such other information as may be required under any relevant *regulatory information instrument*.

(d) If the *AER* determines that a *positive change event* has occurred in respect of a statement under paragraph (c), the *AER* must determine:

(1) the *approved pass through amount*; and

(2) the amount of that *approved pass through amount* that should be passed through to *Distribution Network Users* in each *regulatory year* during the *regulatory control period*,

taking into account the matters referred to in paragraph (j).

(e) If the *AER* does not make the determinations referred to in paragraph (d) within 60 *business days* from the date it receives the *Distribution Network Service Provider's* statement and accompanying evidence under paragraph (c), then, on the expiry of that period, the *AER* is taken to have determined that:

(1) the *positive pass through amount* as proposed in the provider's statement under paragraph (c) is the *approved pass through amount* in respect of that *positive change event*; and

(2) the amount of that *positive pass through amount* that the provider proposes in its statement under paragraph (c) should be passed through to *Distribution Network Users* in each *regulatory year* during the *regulatory control period*, is the amount that should be so passed through in each such *regulatory year*.

Negative pass through

(f)-(h) …………

Consultation

(i) Before making a determination under paragraph (d) or (g), the *AER* may consult with the relevant *Distribution Network Service Provider* and such other persons as the *AER* considers appropriate, on any matters arising out of the relevant *pass through event* the *AER* considers appropriate.

Relevant factors

(j) In making a determination under paragraph (d) or (g) in respect of a *Distribution Network Service Provider*, the *AER* must take into account:

(1) the matters and proposals set out in any statement given to the *AER* by the provider under paragraph (c) or (f); and

(2) in the case of a *positive change event*, the increase in costs in the provision of *standard control services* that the provider

has incurred and is likely to incur until the end of the *regulatory control period* as a result of the *positive change event*; and

(3) in the case of a *positive change event*, the efficiency of the provider's decisions and actions in relation to the risk of the *positive change event*, including whether the provider has failed to take any action that could reasonably be taken to reduce the magnitude of the *eligible pass through amount* in respect of that *positive change event* and whether the provider has taken or omitted to take any action where such action or omission has increased the magnitude of the amount in respect of that *positive change event*; and

(4) the time cost of money based on the *weighted average cost of capital* for the provider for the relevant *regulatory control period*; and

(5) the need to ensure that the provider only recovers any actual or likely increment in costs under this paragraph (j) to the extent that such increment is solely as a consequence of a *pass through event*; and

(6) in the case of a *tax change event*, any change in the way another *tax* is calculated, or the removal or imposition of another *tax*, which, in the *AER's* opinion, is complementary to the *tax change event* concerned; and

(7) whether the costs of the *pass through event* have already been factored into the calculation of the provider's *annual revenue requirement*; and

(8) any other factors the *AER* considers relevant.

Extension of time limits

(k) The *AER* must, by written notice to a *Distribution Network Service Provider*, extend a time limit fixed in clause 6.6.1(c) or clause 6.6.1(f) if the *AER* is satisfied that the difficulty of assessing or quantifying the effect of the relevant *pass through event* justifies the extension.

Retailer insolvency event

(l) For the purposes of calculating the *eligible pass through amount* in relation to a *positive change event* which is a *retailer insolvency event*, the increase in costs ~~must~~ are the retailer insolvency costs excluding:

(i) ~~exclude~~ any amount recovered or recoverable from a *retailer* or a guarantor of a *retailer* under any relevant *credit support* ~~Chapter 6B;~~

(ii) ~~exclude~~ amounts that the *Distribution Network Service Provider* is likely to receive on a winding-up of the *retailer*; and

(iii) ~~exclude~~ any costs that are recoverable under a *RoLR cost recovery scheme distributor payment determination*; and

(iv) ~~be taken to be a cost that can be passed through and not a revenue impact of the event.~~

(m) The amount the *AER* determines should be passed through to *Distribution Network Users* in respect of a *retailer insolvency event* that is a *positive change event* must be taken to be a cost that can be passed through and not a revenue impact of the event.

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