

Ausgrid Submission

AEMC National Electricity Amendment (Deferral of Network charges) rule change

June 2020

25 June 2020



Mitchell Shannon
Australian Energy Market Commission
GPO Box 2603
SYDNEY NSW 2001

24-28 Campbell St
Sydney NSW 2000
All mail to
GPO Box 4009
Sydney NSW 2001
T +61 2 131 525
ausgrid.com.au

Lodged online

Dear Mr Shannon,

We appreciate the opportunity to comment on the Australian Energy Market Commission's (AEMC) Consultation Paper on the proposed Deferral of Network charges rule change.

Ausgrid owns and operates a shared distribution grid that stretches from southern Sydney to the Upper Hunter Valley, including the CBD. This shared network supplies energy to over 4 million customers every day. As the provider of an essential service, we recognise the important role we play, not just in our customers' lives, but in enabling a significant part of the Australian economy.

The COVID-19 pandemic is having a significant impact on our customers. In response, governments and private industry have delivered a range of measures to support customers. After incorporating feedback from retailers in April 2020, Ausgrid, in partnership with Endeavour Energy and Essential Energy, implemented a NSW networks relief package in early May. This package addressed an emerging risk that the COVID-19 shutdown would place small business and residential customers under significant financial pressure.

The AER's proposed rule seeks to mitigate the risk of multiple retailer failures due to COVID-19. Based on current indicators, including retailer requests for the deferral or waiver of network charges through our NSW relief package, we do not consider there is clear evidence to support the need for the proposed rule at this time. However, we recognise that the AEMC may take a different view, and our submission outlines several key principles that the AEMC should address prior to determining a new rule:

- **Demonstrated need** – the AEMC should demonstrate that a rule is needed and supports the long-term interests of customers, as required by the National Electricity Objective
- **Proportional and targeted response** – it is essential that any final rule is strictly limited to those retailers and customers that have a demonstrated need for support
- **Minimises unintended consequences** – as currently drafted, the proposed rule could have significant cash flow implications for distributors, which in turn could have unintended consequences for customers.
- **Appropriate risk allocation** – contrary to statements in the AER's rule change proposal, the draft rule transfers risk from retailers to distributors. If the rules are changed in this way, the rationale for doing so should be clearly explained.

We appreciate the AEMC's consultative approach on these issues to date. Due to the complexity of the issues still to be resolved, we support an extension of the expedited rule change process to allow for a further, targeted round of consultation.

If you have any queries in respect of this submission, please contact John Skinner on (02) 9269 4367 or john.skinner@ausgrid.com.au

Yours sincerely

A handwritten signature in black ink, appearing to read 'Iftekhar Omar'.

Iftekhar Omar
Head of Regulation

Attachment A: High level comments

We recognise that the COVID-19 pandemic is having a significant impact on customers. Governments and regulators are rightly concerned to ensure that the impact of COVID-19 is ameliorated as much as possible, both from a health perspective, as well as from an economic and societal perspective.

Significant and unprecedented measures have been implemented to support customers during the COVID-19 pandemic. Many of these measures provide direct assistance to customers in covering their living costs, including their energy bills. The AEMC must ensure that any final rule is proportional and appropriately targeted to ensure there are no unintended long-term implications for customers.

Our submission provides views on some of the key issues raised by the proposed AER rule change and is structured as follows:

- Attachment A provides high level comments on the proposed rule change, including the key principles that must be addressed prior to a final rule being made.
- Attachment B provides detailed answers to the AEMC's consultation questions.
- Confidential Attachment C sets out some of the key financial and cashflow risks associated with the proposed rule.

We also support the submission lodged by Energy Networks Australia.

Demonstrated need for proposed rule

The AER's proposed rule seeks to mitigate the risk of multiple retailer failures due to COVID-19. As outlined in the sections below, currently available evidence does not suggest that this is a likely occurrence. Therefore, we do not consider that there is an evidenced or demonstrated need for the proposed rule at this time.

NSW relief package

To assist customers during the COVID-19 pandemic, the NSW distributors implemented a relief package that allows retailers to defer, or seek a rebate for, the network charges for certain classes of residential and small business customers impacted by COVID-19. The NSW relief package was designed following two rounds of consultation with all NSW retailers, who expressed their appreciation for our pragmatic approach.

The key aspects of the relief package are:¹

- Small retailers can defer 20% of all residential network charges until the end of September 2020;
- Small retailers can receive an immediate rebate for the network charges of residential customers that go into default due to COVID-19;
- Large retailers can defer the network charges of residential customers who go on payment plans or hardship arrangements put in place due to COVID-19; and
- All retailers can receive an immediate rebate of network charges for small business customers experiencing financial distress due to COVID-19.

As at 25 June 2020, the number of retailer requests for the deferral or rebate of network charges has been very low. Of the retailers signed up to Ausgrid's relief package, 64% have not processed any

¹ <https://www.ausgrid.com.au/About-Us/Who-we-are/Policies-and-reports/Hardship/ENA-Relief-Package>

rebates or deferrals. In confidential Attachment C we outline the value of rebates and deferrals sought to date. This evidence appears to demonstrate that the need for 'urgent cashflow relief', which was initially a key concern for retailers, has not yet eventuated.

AER COVID Dashboard

To provide visibility of the impact COVID-19 is having on energy customers, the AER called on retailers to provide additional data on a voluntary basis.

In its latest COVID-19 dashboard, the AER reported that the number of customers on payment plans and hardship customers are roughly the same as before the COVID-19 outbreak. As the AER notes, this may reflect the fact that retailers are offering customers the option to defer outstanding payments, rather than placing them on formal hardship arrangements.

Based on the data currently available, it is difficult to draw the conclusion that there is a real possibility of multiple retailer failures.

Lower wholesale energy prices

Wholesale energy costs make up a significant proportion of a retailer's costs.

In its May 2020 quarterly wholesale markets update, the AER reported that energy costs were low in Q1 2020, with Queensland, Tasmania, South Australia and Victoria recording their lowest Q1 prices since 2012, 2015, 2016 and 2017 respectively.² It was also the first time since 2015 that Q1 average prices were below \$110 per MWh in each region, driven by lower summer demand and a record number of negative prices in Q1.

Retailers have started offering lower prices to customers, and we expect that the current low wholesale prices will ease the pressure on all retailers.³

Proportional and targeted response

The AER's rule change proposal left many details of the proposed rule still to be answered. In our view, it is essential that any final rule is strictly limited to those retailers and customers that have a demonstrated need for support. This will reduce the risk of unintended consequences from the proposed rule.

Retailer eligibility

We strongly support limiting application of the scheme to those retailers unable to access an alternative source of funds. For this reason, the following classes of retailers should be excluded:

- Government owned retailers
- Retailers listed on the Australian stock exchange, or owned by a related body corporate on the Australian stock exchange
- Retailers listed on an overseas stock exchange, or owned by a related body corporate on an overseas stock exchange.

² AER, *Wholesale quarterly report*, May 2020, p5

³ <https://www.originenergy.com.au/about/investors-media/media-centre/origin-lowers-electricity-and-natural-gas-prices-for-customers-in-nsw-sa-qld-and-act.html>

Consistent with proposed retailer support models in the UK and New Zealand, we also support independent certification that:

- the retailer is likely to experience liquidity problems in the next 6 months;
- that those problems have arisen due to COVID-19; and
- that those liquidity problems cannot be addressed by the retailer obtaining a capital injection or loan from a related party.

Minimises unintended consequences

The AER's rule change proposal suggests that customers will benefit through the proposed rule's support for continued retail competition and retailers' ability to offer hardship assistance to customers.

As part of its assessment, the AEMC should ensure that it considers these short-term objectives against the potential long-term impacts of the proposed rule, for both customers and investors:

- Shifting liquidity from networks to retailers may result in customers paying more in the long run. As currently drafted, the proposed rule would have a significant cash flow impact for network businesses, which could impact debt costs into the future. In confidential Attachment C we outline some of the potential cash flow implications.
- There is a risk that the long-term certainty generally associated with investment in network assets is being eroded. Recent regulatory decisions such as the binding rate of return guideline, together with the AER Tax Review and Productivity Review have significantly impacted network revenue. Any rule change which is not proportionate may further diminish investor confidence in the regulatory regime.

Appropriate risk allocation

We are concerned that the rule change would re-allocate risks from retailers to distributors.

The AER rule change proposal states that the proposed rule does not transfer risk from the retailers to the distributors. The rule change proposal states:

The proposed rule change preserves the existing allocation of risk between retailers and networks.⁴

This is echoed in the AEMC consultation paper when it states that the rule change proposal:

...is not intended to change the allocation of risk between retailers and NSPs.⁵

As mentioned in Box 1 of the Consultation Paper, we support the AEMC view that "risks should generally rest with the participants that are best placed to manage them".

Network businesses are regulated with the intent of providing revenue certainty. As a result, networks receive a low rate of return, which is controlled through the revenue cap framework. However, as fixed cost businesses, networks have limited ability to respond quickly to significant changes in the regulatory and operating environment. As a result, recent regulatory changes, when compounded by

⁴ AER, *Rule Change Request – Extension of time for retailers to pay networks*, p2

⁵ AEMC Consultation Paper, *Deferral of Network Charges Rule Change*, p18

significant and unforeseen events which create revenue volatility, may create liquidity concerns for distributors.

Liquidity risk is the risk that a business will not have sufficient funds to meet its obligations in a timely manner. In the AEMC's Credit Support rule change process, the AEMC expressed the view that distributors will be "able to quickly access funds, either from internal or external sources, to manage any cash-flow shortages arising from non-payment of network charges as a result of retailer default".

In the AER rule change proposal and the AEMC consultation paper, neither the AER or AEMC have identified where the network businesses will quickly access funds from, should they be required. However, there seems to be a view that network businesses are not subject to liquidity risk and have cash 'on tap' whenever they want it.

Network businesses are subject to the same constraints as other firms when it comes to accessing funds. These constraints are likely to be more acute during times of market volatility, such as the present circumstances.

The Retailer of Last Resort pass through event and the proposal to allow distributors to charge interest on deferred payments do not address this liquidity risk issue. While our efficient costs are reimbursed under these two options, which both ensure that businesses are kept whole from a value perspective, neither address short term liquidity risk.

Ongoing collaboration essential

We appreciate the consultative approach taken by the AEMC to date. Given the number of complex issues still to be resolved, we strongly support an extension of the rule change time period to allow for further analysis and consultation.

More broadly, we recognise that COVID-19 has placed increased pressure on many stakeholders in the energy sector. It is important that market bodies, Governments and industry stakeholders, continue to engage with each other, and, more importantly, with customers, throughout these difficult times. This will ensure that any policy or regulatory responses are appropriate and in the long-term interests of customers.

Attachment B: Response to consultation questions

CHAPTER 4 – SECTION 4.1 – THE PROBLEM - IMPACT OF COVID-19 ON THE RETAIL ELECTRICITY MARKET

Question 1 – Impact of COVID-19 on retailers

<p>a) What is the expected impact of COVID-19 on retailers' cash flows? How material is this impact? How long are these cash flow impacts expected to last?</p>	<p>The expected impact of COVID on retailers' cash flows is obviously difficult to predict.</p> <p>As at 25 June 2020, the number of retailer requests for the deferral or rebate of network charges has been very low. Of the retailers signed up to Ausgrid's relief package, 64% have not processed any rebates or deferrals. In confidential Attachment C we outline the value of rebates and deferrals sought to date. This evidence appears to demonstrate that the need for 'urgent cashflow relief', which was initially a key concern for retailers, did not eventuate.</p>
<p>b) In the absence of the proposed rule change, what options are available to retailers to manage the cash flow impacts of COVID-19? Are existing support schemes that have been announced, including the Network Relief Package, sufficient to assist retailers to manage these impacts? If not, what are the areas where further assistance is needed?</p>	<p>As outlined in Attachment A to this submission, there is little currently available evidence demonstrating that available support mechanisms, including the network relief packages, will not be sufficient to manage the impact of COVID-19. We also expect that the current low wholesale costs will ease the pressure on retailers.</p>
<p>c) What are the expected impacts of the proposed rule change on any cash flow issues currently being experienced by retailers as a result of COVID-19?</p>	<p>No response.</p>

CHAPTER 4 – SECTION 4.2.1 – ELIGIBILITY TO DEFER PAYMENT OF NETWORK CHARGES

Question 2 – Retailer eligibility

<p>a) Is it appropriate and/or necessary to expressly exclude certain classes of retailer from deferring the payment of network charges under the proposed rule change? If so, please provide reasoning to support your position.</p>	<p>Yes, it is appropriate to exclude certain classes of retailer from relief under the proposed rule. The limitations on retailer eligibility should also be explicit, with well-defined criteria regarding eligibility.</p> <p>Networks should not be required to support:</p> <ul style="list-style-type: none"> • Government owned retailers • Retailers listed on the Australian stock exchange, or owned by a related body corporate on the Australian stock exchange • Retailers listed on an overseas stock exchange, or owned by a related body corporate on an overseas stock exchange. <p>These classes of retailers have alternative sources of capital and should not be inefficiently supported with revenues collected from all electricity customers through network charges.</p>
<p>b) If the onus is placed on retailers to show they have a legitimate financial need to access the proposed deferral mechanism, what eligibility criteria should apply?</p>	<p>Retailer eligibility should require independent certification of the following requirements:</p> <ul style="list-style-type: none"> • the retailer is likely to experience liquidity problems in the next 6 months; • that those problems have arisen due to COVID-19; and • that those liquidity problems cannot be addressed by the retailer obtaining a capital injection or loan from a related party
<p>c) What would be an appropriate and efficient process for the verification of information provided by retailers under the approach described in (b) above?</p>	<p>We support an independent auditor, approved by the AER, certifying that a retailer requires assistance.</p> <p>As well as providing the report to the relevant distributor, the AER should also be required to publish a notice on its website that support is being provided to that retailer.</p>
<p>d) Do stakeholders have views on how the deferral mechanism could be designed to incentivise only those retailers that legitimately require immediate financial support due to COVID-19 to access this mechanism (including allowing DNSPs to charge interest on deferred payments)?</p>	<p>We support the payment of interest on deferred payments.</p> <p>The proposed rule requires distributors to bear more significant risks than contemplated under the regulated rate of return. An interest rate aligned to the commercial risks of a retailer would be appropriate.</p>
<p>e) Do stakeholders have views on whether any of the approaches outlined above (or a combination of each) would be preferable?</p>	<p>No comment</p>

Question 3 – Customer eligibility

a) Do stakeholders have views on the types of customers that should be captured by the proposed deferral mechanism and how these customers can be clearly defined in the NER? Is it appropriate and/or necessary for this mechanism to include large commercial and industrial customers?

Consistent with the AER's Statement of Expectations and the NSW distributors' relief package, in our view the proposed rule should only apply to residential and small business customers. This is an appropriate policy response, given that many other protections under the regulatory framework, such as those provided under the National Energy Customer Framework, are similarly provided to households and small business customers.

CHAPTER 4 – SECTION 4.2.2 – DEFERRAL TIMEFRAME AND TERMS

Question 4 – Length of deferral period

<p>a) Is a six-month deferral of the payment of network charges an appropriate timeframe, having regard to the potential cash flow impacts of COVID-19 on the retail electricity market in the second half of 2020? Alternatively, would a shorter deferral timeframe be sufficient to allow retailers to overcome the financial pressures posed by the current environment?</p>	<p>Cashflow coverage ratios are calculated on a 12-month rolling quarterly basis. Depending on eligibility and extent of need, any extension of retailer payment terms and business specific factors will impact networks' ability to meet their cash flow covenants.</p>
<p>b) What are the implications (if any) of a six-month deferral period for NSPs, compared to a shorter or longer deferral period?</p>	<p>A deferral of network charges will transfer liquidity risk from the retailers to distributors. The longer the deferral period, the greater the risk for distributors. A longer period will also increase the likelihood that a retailer will not be able to meet its obligations at the end of the period.</p>

Question 5 – Extension of deferral period

<p>a) Is it appropriate and/or necessary for the AER to have the ability to extend the deferral period if this is considered necessary? If so, what conditions, considerations and/or consultation requirements should reasonably apply to the exercise of this power?</p>	<p>No, we do not think this is appropriate.</p> <p>However, if the AER is granted the power to extend the deferral period, the AEMC should establish clear decision criteria for the power to be exercised. The relevant criteria might include:</p> <ul style="list-style-type: none"> • the percentage of retailers already opting in to the deferral scheme, • hardship indicators through the AER COVID dashboard and • the views of stakeholders. <p>Importantly, the AER should be required to conduct a short consultation process seeking the views of stakeholders prior to exercising the power to extend the scheme.</p>
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CHAPTER 4 – SECTION 4.2.3 – DEFERRAL OF PAYMENTS BETWEEN DNSPS AND TNSPS

Question 6 – Deferral of payment of transmission network charges

<p>a) Is it necessary and/or appropriate for DNSPs to be able to defer the payment of transmission charges to TNSPs under the proposed deferral mechanism? To what extent would this change the overall impact of the proposal on DNSPs? What would the impact of this approach be on TNSPs?</p>	<p>In our view, DNSPs should be able to defer the payment of transmission charges.</p> <p>If the intent of the proposed rule change is for industry to support retailers, then the distribution, transmission and generation sectors should all provide support. There is no reason why transmission businesses, which are regulated under a very similar regime to distributors, should not provide support.</p> <p>We expect to finalise an agreement on how TransGrid should implement the transmission component of the NSW networks customer relief package by the end of June 2020. Our draft agreement is guided by principles rather than proscriptive rules. NUOS charges will be broken down into DUOS, TUOS and jurisdictional charges, with a further process to calculate TransGrid's share of TUOS revenue.</p> <p>The process for implementing transmission payment rebates and deferrals is based on "B2B" disputes that are raised by the NSW electricity distributors and then verified by TransGrid. Similar arrangements could be extended for a final rule made by the AEMC.</p>
<p>b) Do stakeholders have views on how the deferral of payments from DNSPs to TNSPs would be implemented in practice? What issues would need to be addressed in the regulatory framework to facilitate this?</p>	<p>The AEMC should focus on a principles based approach in any final rule that avoids unnecessary prescription.</p> <p>Any final rule should take into account that some electricity distributors, like Ausgrid, have dual function assets and therefore receive a share in the total TUOS revenue recovered in a region.</p> <p>We recommend that the AEMC uses the final agreement reached between the NSW electricity distributors and TransGrid as a guide for a principles based approach.</p>

CHAPTER 4 – SECTION 4.3 – PRACTICAL IMPLEMENTATION OF PAYMENT DEFERRALS

Question 7 – Process for deferring payment of network charges

<p>a) Do stakeholders have views on appropriate processes which could be adopted to facilitate the proposed payment deferrals in an expedient manner?</p>	<p>During the consultation process to establish the NSW relief package, retailers indicated that the process adopted to implement any deferral arrangements should leverage existing market arrangements as far as possible.</p> <p>Accordingly, the NSW relief package leverages existing B2B arrangements for the rebating and deferral of network charges: https://www.ausgrid.com.au/About-Us/Who-we-are/Policies-and-reports/Hardship/ENA-Relief-Package</p> <p>In our view, any rule deferring the payment of network charges for eligible retailers should utilise the processes already agreed between distributors and retailers. This will ensure that any arrangements can be implemented as efficiently as possible.</p>
<p>b) Could the processes agreed between retailers and NSPs for implementing the Network Relief Package also be used to implement the AER's proposal?</p>	<p>Yes</p>
<p>c) If the details of this process are not prescribed in the NER, what alternative approaches would ensure that the payment deferrals could be administered in a transparent, consistent and efficient manner? Is it feasible for the details of this process to be directly agreed between NSPs and retailers?</p>	<p>A possible approach is for the rules to proscribe that distributors and retailers must negotiate in good faith to establish arrangements for the deferral of network charges.</p> <p>The AEMC's final decision could outline the AEMC's expectation that similar arrangements to those adopted in the jurisdictional relief packages could be adopted.</p>

CHAPTER 4 – SECTION 4.4 – IMPACT ON NSPS

Question 8 – Impact of proposed deferral mechanism on NSPs

<p>a) Would a six-month deferral of the payment of network charges present a material financial risk to NSPs? If so, are there ways of addressing or reducing these risks through the design of the deferral mechanism?</p>	<p>It is possible that the rule change proposal in its current form could present material financial risk to some, if not all, networks. See Confidential Appendix C for further information.</p>
<p>b) Do NSPs have views on whether, in practice, the annual pricing proposal process would allow NSPs to recover any deferred revenue in the following regulatory year as described above? Are there any issues that may arise in seeking to utilise this process for this purpose?</p>	<p>In accordance with accounting standards, revenue is recognised in the period when the network services were provided, regardless of when the cash is paid. The recovery of deferred revenue therefore cannot occur through the annual pricing process and any proposal to apply interest on deferred payments will need to be incorporated in the proposed rule.</p>
<p>c) Do stakeholders have views on whether NSPs should be reimbursed for direct costs incurred as a result of the deferred payments and, if so, what would be the best mechanism for achieving this?</p>	<p>As outlined in question 2(d), we support the proposal for interest to be applied on deferred payments, with the arrangements outlined in any proposed rule.</p>
<p>d) If NSPs were to be reimbursed for their efficient costs (as well as recovering their total regulated revenue), do NSPs consider there would be any residual risk to their business arising from the deferral of network charges?</p>	<p>See Confidential Appendix C</p>

Thank you

Thank you

