AEMC

RULE

Australian Energy Market Commission

CONSULTATION PAPER

# NATIONAL ELECTRICITY AMENDMENT (DEFERRAL OF NETWORK CHARGES) RULE 2020

**PROPONENT**

Australian Energy Regulator

28 MAY 2020

## INQUIRIES

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## ABOUT THE AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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# 1 INTRODUCTION

On 6 May 2020, the Australian Energy Regulator (AER) (proponent) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) seeking to amend the National Electricity Rules (NER) to allow electricity retailers to defer the payment of some network charges incurred between 1 July 2020 and 31 December 2020 to distribution network service providers (DNSPs) for six months. The AER's proposal is intended to allow retailers to focus on the ongoing supply of energy as an essential service, and support for customers, as they deal with the cash flow pressures arising as a result of the COVID-19 pandemic. The rule change request therefore proposes that retailers only be eligible to defer the payment of network charges in respect of customers whose ability to pay their electricity bill has been impacted by COVID-19.

In submitting its rule change request, the AER has requested that it be subject to the expedited rule making process on the basis that it is an "urgent rule" as defined in the National Electricity Law (NEL). The AER states that the rule change is urgently needed to support the resilience of retailers adversely affected by the COVID-19 pandemic. This would mitigate risks of financial contagion and adverse impacts on competition in the national electricity market (NEM).

The Commission considers that the rule change request should be treated as an urgent rule change under the NEL. The rationale for this position is discussed in detail in chapter 5. In summary, the Commission considers that if the rule change request is not considered as quickly as possible:

- the effective operation and administration of the wholesale electricity market would be imminently prejudiced or threatened due to the impacts of COVID-19 on retailers' cash flows and the associated risk of multiple retailer failures leading to financial contagion in the NEM
- the purpose of the AER's proposal would be significantly negated, as delay in introducing the proposed deferral mechanism would mean the payment deferrals would not apply to network charges incurred in the period when cash flow relief is most likely to be needed for retailers to be able to support customers affected by COVID-19.

This consultation paper has been prepared to facilitate public consultation on the rule change request and to seek stakeholder submissions.

The remainder of this paper:

- provides a summary of, and background to, the rule change request
- identifies a number of questions and issues to facilitate consultation on this rule change request
- outlines the process for making submissions to this consultation paper and objections to the expedited process.

Stakeholders can request that any information in their submission be treated as confidential.

## 1.1 Context

Millions of Australians' incomes have been affected by job losses, pay reductions or reduced work hours, or an inability to work due to needing to care for family members as a result of COVID-19. In mid-April, the Commonwealth Treasury forecast unemployment to increase from 5.2 per cent at the beginning of March to 10 per cent by June.[1] In April, the official unemployment rate increased to 6.2 per cent, or an additional 104,500 unemployed people (looking for work). This figure does not account for the other almost 500,000 people who dropped out of the work force. In addition, the underemployment rate increased to almost 14 per cent, its highest level on record.[2] Other institutions have estimated unemployment will be higher. For example, the Grattan Institute estimated the rate would likely sit between 14 and 26 per cent.[3] The variation in these estimates underlines the uncertainty of estimating the economic and employment impact of the crisis.

Many households that previously had full time employment may experience financial hardship for the foreseeable future through increased job insecurity, difficulty finding new jobs and reduced income. This increased sense of insecurity may influence a consumer's ability and willingness to pay energy bills.

Small business consumers have also been affected significantly by the pandemic. Social distancing restrictions imposed by governments have impacted small business across various industries. In April, almost three quarters of Australian businesses (72 per cent) reported that reduced cash flow is expected to have an adverse impact on business over the next two months.[4]

## 1.2 Key dates for rule change

The Commission considers that this rule change request is a request for an urgent rule under the NEL, and therefore has decided to use the expedited rule change process, provided it does not receive any valid requests not to do so.[5] Under section 96 of the NEL, stakeholders may object to the Commission using the expedited process.

Consistent with the timelines and requirements for an expedited rule change process under the NEL, the key dates for stakeholders in this process are as follows:

- Commencement of the rule change process: **28 May 2020**
- Objections to the Commission’s decision that the rule change request is a request for an urgent rule (and be subject to the expedited process) to be received by: **11 June 2020**
- Submissions to the consultation paper to be received by: **25 June 2020**

1 Treasurer of the Commonwealth of Australia, JobKeeper payment supporting millions of jobs, 14 April 2020, accessed at: https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/jobkeeper-payment-supporting-millions-jobs

2 https://www.abc.net.au/news/2020-05-14/coronavirus-australia-job-market-unemployment-figures-april/12247990

3 Grattan Institute, Shutdown: estimating the COVID-19 employment shock, April 2020, p. 3.

4 Australian Bureau of Statistics, *5676.0.55.003 - Business Indicators, Business Impacts of COVID-19, April 2020*. Available at: https://www.abs.gov.au/ausstats/abs%40.nsf/mediarbeyond%20the%20eleasesbyCatalogue/49F8475B31112582CA2585360076 4041?OpenDocument

5 See section 5.1 of this consultation paper for more information on the treatment of this rule change request as urgent.

- Final determination and final rule to be published under an expedited process by: **23 July 2020**.

A template for submissions to the consultation paper is available on the rule change project page (https://www.aemc.gov.au/rule-changes/deferral-network-charges).

# 2 DETAILS OF THE RULE CHANGE REQUEST

This chapter outlines the:

- issues raised in the rule change request
- proposed solution.

## 2.1 Issues raised in the AER's rule change request

The AER's rule change request notes that many electricity customers in the NEM are facing difficulties paying their bills as a result of the economic impacts of the COVID-19 pandemic, with over 20,000 electricity customers registering for payment plans since early March 2020 and over a thousand customers per week currently seeking assistance from retailers. The AER considers that the COVID-19 pandemic could potentially lead to multiple retailer failures and thereby undermine the operation of retail electricity markets. This is due to the financial pressures on retailers resulting from the potential divergence between their incoming cash flows from customers affected by the pandemic and their outgoing cash flows required to satisfy their obligations to pay wholesale and network energy charges.

The AER notes that its Statement of Expectations of energy businesses outlines the support the AER expects energy retailers to provide to customers during the COVID-19 pandemic, including that retailers do not disconnect customers who may be in financial stress for non-payment of their electricity bills before 31 July 2020 and potentially beyond. This arrangement means that retailers bear the risk of incurring ongoing network and wholesale energy costs without matching revenue streams to meet those costs.

The AER also considers that the Retailer of Last Resort (RoLR) mechanism, which provides for customers to transfer to another retailer in the event of retailer failure, may not be capable of mitigating the risk of multiple retailers failing as a result of COVID-19 induced financial pressures.

The Electricity and Gas Network Relief Package (Network Relief Package) established by network businesses in New South Wales, Victoria and South Australia is designed to provide some financial relief to customers (and, by extension, retailers) enduring hardship as a result of COVID-19.[6] The Network Relief Package provides for:

- the deferral of network charges incurred from 1 April 2020 to 30 June 2020 for residential customers of certain large retailers[7] who are put on a payment plan or hardship arrangement as a result of the pandemic
- rebates for network charges incurred from 1 April 2020 to 30 June 2020 for:
    - residential customers of small retailers that "go into default" as a result of the pandemic

6 For more information, see https://www.energynetworks.com.au/news/media-releases/2020-media-releases/energy-network-relief-package-announced/.

7 Customers of AGL Energy, EnergyAustralia, ERM Power, Lumo Energy, Momentum Energy, Origin Energy, Red Energy and Simply Energy may be eligible for the deferral.

- small business customers of all retailers that use less than 25% of historical average consumption for that period.

The rebates are to be provided to retailers by the end of September 2020.

The Commission understands that the Network Relief Package is being implemented on a jurisdictional basis and the details of the relief being provided is being further developed following consultation between NSPs and retailers. The Commission will provide further information on the implementation of the package as it becomes publicly available.

In the AER's view, the economic impacts of COVID-19 and the associated impact on retailers' revenue streams will continue to manifest throughout the second half of 2020. The AER therefore considers it necessary that this financial support be extended beyond June 2020.

## 2.2 Proposed solution

### 2.2.1 Deferral of payment of network charges by retailers

The AER's rule change request proposes that the NER be amended to provide for the payment of some network charges by retailers incurred between 1 July 2020 and 31 December 2020 to be deferred for an initial period of six months. This deferral would only apply to network charges incurred in relation to customers on a "COVID-19 customer arrangement" during this period. This would capture any customer who, between 1 March 2020 and 31 December 2020, entered into:

- a payment plan or instalment arrangement[8]
- any arrangement as a hardship customer[9]
- any deferred debt arrangement.[10]

The deferral mechanism would not apply to customers who became hardship customers or were on a payment plan, instalment arrangement or deferred debt arrangement prior to 1 March 2020.

Under the AER's proposal, all retailers would be able to defer the payment of network charges for eligible customers. However, the AER suggested that the Commission consider whether only certain retailers should be eligible to access this support and, if so, how this should be determined. This issue is discussed further in section 4.2.1.

The AER notes that retailers would still be responsible for managing the risk of customer default and NSPs would remain entitled to recover the full amount of their regulated revenues as determined by the AER. The AER identified some options under the existing regulatory framework which may allow networks to recover the efficient costs they may incur as a result of the proposed deferral mechanism, including:

8 The NERL defines "payment plan" as a plan for a hardship customer, or a residential customer who is not a hardship customer but who is experiencing payment difficulties, to pay a retailer, by periodic instalments in accordance with the Rules, any amounts payable by the customer for the sale and supply of energy.

9 The NERL defines "hardship customer" as a residential customer of a retailer who is identified as a customer experiencing financial payment difficulties due to hardship in accordance with the retailer's customer hardship policy.

10 The AER's proposal defines "deferred debt arrangement" as any arrangement by which the payment of a debt owed or expected to be owed by a shared customer to a retailer for the supply of energy is deferred.

- charging retailers interest on the deferred payments at the default interest rate
- passing the costs through to network customers under existing cost pass through mechanisms (although the AER notes the threshold for these mechanisms may not be exceeded unless the impact on retailers is sustained and severe).

### 2.2.2 Deferral timeframe

As discussed above, the AER's proposal would allow the payment of some network charges to be deferred by six months. At the end of the deferral period, the retailer would be required to pay the deferred network charges regardless of whether the retailer has been paid by the relevant customer. Given that the payment deferral could relate to network charges incurred up to 31 December 2020, the effects of the proposed rule would conclude six months after the invoicing of network charges for the October to December quarter of 2020, which is expected to be between July and August 2021 (subject to extension by the AER as discussed below).

The AER has also proposed that it be given the power under the rules to extend the deferral period beyond 31 December 2020 if the AER considers it reasonably necessary to do so. This issue is discussed further in section 4.2.2.

### 2.2.3 Rule making process and commencement

As discussed in section 2.1, this rule change request is seeking to address the unprecedented circumstances presented by COVID-19 and the significant financial risks the current economic environment poses for electricity retailers. On that basis, the AER has requested that the Commission treat the rule change proposal as an urgent rule under the NEL. The AER has proposed that the rule commence on 1 July 2020 so that it would apply to statements of charges issued by NSPs to retailers from that date until 31 December 2020. The process for this rule change, including the proposal to treat the rule change as urgent, is discussed further in section 5.1.

# 3 ASSESSMENT FRAMEWORK

This chapter outlines the:

- decision-making framework the Commission must apply to determine whether the rule change request contributes to the national energy objective (NEO)
- Commission's proposed assessment framework
- Commission's option to make a more preferable rule
- Commission's option to make a differential rule.

## 3.1 Achieving the NEO

Under the NEL the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the national electricity objective (NEO).[11] This is the decision making framework that the Commission must apply.

The NEO is:[12]

> to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to -
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

Based on a preliminary assessment of this proposed derogation, the Commission considers that the relevant aspects of the NEO are the price, safety, reliability and security of the supply of electricity.

## 3.2 Proposed assessment framework

To determine whether the rule change request promotes the NEO, the Commission will assess the rule change request against an assessment framework, which includes the following criteria:

- **Promoting financial resilience** — whether the rule change proposal would support industry viability and financial resilience by deferring costs for retailers facing cash flow risks as a result of the COVID-19 pandemic. This could therefore reduce the potential for multiple retailer failures and financial contagion attributable to the impact of COVID-19. The support that may be provided by the financial relief may also support the continuation of a competitive market structure, which in turn will support better pricing outcomes for consumers.
- **Efficient allocation of risk** — whether the rule change proposal would appropriately allocate any associated risk and cost to the parties best placed to manage them. This would involve consideration of the risk profiles of different market participants, including

11 Section 88 of the NEL.

12 Section 7 of the NEL.

businesses within the same participant class, and the implications for the design of the proposed deferral mechanism. The rationale for the allocation of risk under existing regulatory arrangements is discussed in Box 1.

- **Implementation costs** — where costs are imposed in implementation and cannot be mitigated through market mechanisms, these costs should be minimised relative to the benefits of the proposed deferral mechanism.

### BOX 1: RISK ALLOCATION IN THE NEM

Electricity retailers carry the credit and cash-flow risks for the entire electricity supply chain. Notably, retailers are required to make payments for non-retail supply chain components, including network charges, by defined time frames regardless of the level of non or late-payment by customers.

The Commission considers that risks should generally rest with the participants that are best placed to manage them. As the participant with direct relationships with customers, retailers are best placed to manage the risk of non or late-payment by customers. For example, for small consumers retailers have developed strategies such as pay on time discounts, late payment fees and advanced payments to manage late payment risks. For large consumers, retailers are able to negotiate terms within their contracts to ensure timely payment (for example, credit support). Retailers may also build in the cost of late or non-payment into their prices. Retailers bearing this risk therefore generally represents an efficient allocation of risk within the sector.

As suppliers of essential services, energy retailers enter the NEM with knowledge that they are required to continue to supply small customers who do not pay, or pay late, to a greater degree than retailers of most products and services in the economy. These requirements are set out within the hardship and disconnection regulations in the National Energy Retail Law (NERL) and National Energy Retail Rules (NERR). Where retailers are not able to withstand increases in the level of non or late-payment, the Commission generally considers these retailers will exit the market and this a feature of the competitive process.

However, the unprecedented circumstances presented by the COVID-19 pandemic may justify providing assistance to retailers to manage cash flow risks that are exceptions to the usual efficient allocation of cash-flow risk within the sector. In particular, the AER's Statement of Expectations of energy businesses[1] expects retailers to continue to supply non-paying customers to a greater degree than could have been foreseen by retailers before the crisis.

Source: 1. AER, *AER Statement of Expectations of energy businesses: Protecting consumers and the energy market during COVID-19,* March 2020.

## 3.3 Making a more preferable rule

Under s. 91A of the NEL, the Commission may make a rule that is different (including materially different) to a proposed rule (a more preferable rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule will, or is likely to, better contribute to the achievement of the NEO.

## 3.4 Making a differential rule

Under the Northern Territory legislation adopting the NEL, the Commission may make a differential rule if, having regard to any relevant MCE statement of policy principles, a different rule will, or is likely to, better contribute to the achievement of the NEO than a uniform rule. A differential rule is a rule that:

- varies in its term as between:
  - the national electricity system, and
  - one or more, or all, of the local electricity systems, or
- does not have effect with respect to one or more of those systems

but is not a jurisdictional derogation, participant derogation or rule that has effect with respect to an adoptive jurisdiction for the purpose of s. 91(8) of the NEL.

As the proposed rule relates to parts of the NER that currently do not apply in the Northern Territory, the Commission has not assessed the proposed rule against additional elements required by the Northern Territory legislation.[13]

13 From 1 July 2016, the NER, as amended from time to time, apply in the NT, subject to derogations set out in regulations made under the NT legislation adopting the NEL. Under those regulations, only certain parts of the NER have been adopted in the NT. (See the AEMC website for the NER that applies in the NT.) National Electricity (Northern Territory) (National Uniform Legislation) Act 2015.

# 4 ISSUES FOR CONSULTATION

## 4.1 The problem - impact of COVID-19 on the retail electricity market

One of the major concerns raised by the AER in its rule change request is the impact of the COVID-19 pandemic on industry costs and capacity, and the extent to which that may impact the financial resilience of the NEM and its participants, and the secure and reliable operation of the NEM. This section explores the reasons why retailers in particular are under financial pressure and questions whether a deferral of the payment of network charges would relieve these cash flow and capacity pressures.

The COVID-19 pandemic could adversely impact the cash flows of retailers. In particular, retailer revenues are at risk from:

- Increased average customer debt, which could occur due to increased unemployment, a decline in total wages paid to employees and/or increased household electricity consumption and costs as more people work from home. The AER's Statement of Expectations states that the AER expects that retailers not disconnect any residential or small businesses customers who may be in financial stress.
- Lower consumption from small business, and commercial and industrial customers who have closed or scaled down during lock down.
- Increased costs related to expanding their call centre capacity to deal with increased customer interactions.

Retailers' cash flows may also be impacted by the type and degree of hedging they have in place and their retail load shape and size. If they have locked in electricity volumes higher than their customers' current consumption level, a different load profile than currently observed, or prices that are above current spot price levels, then their wholesale costs may not have fallen despite falls in aggregate customer demand and the associated falls in revenue.

The Commission is interested in understanding the extent to which COVID-19 has impacted retailers' cash flows.

The Commission is also interested to know the extent to which a deferral of the payment of network charges as proposed by the AER would alleviate the cash flow risks being faced by retailers. The Commission notes that one of the objectives of the rule change request is to support the financial resilience of the energy industry, and whether this could be done by allowing retailers to defer expenditure related to network charges. The Commission acknowledges that the impact of the deferral would impact each participant differently, depending on a range of factors such as:

- the extent to which a particular retailer is experiencing cash flow pressure as a direct result of the impacts of the COVID-19 pandemic on its customers' ability to pay their bills
- whether it is viable in the current environment for the retailer to secure additional funds from the market to address these cash flow issues.

QUESTION 1: IMPACT OF COVID-19 ON RETAILERS

(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?

(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?

(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?

## 4.2 Proposed solution - key design elements

This section sets out a range of issues relating to the design of the deferral mechanism proposed in the AER's rule change request on which the Commission is seeking stakeholder feedback.

### 4.2.1 Eligibility to defer payment of network charges

**Retailer eligibility**

The AER's rule change proposal would allow all retailers to defer the payment of some network charges incurred between 1 July 2020 and 31 December 2020 for eligible customers for six months. However, the AER acknowledged that the application of the payment deferrals could be narrowed to certain retailers that satisfy reasonable conditions of accessing this support mechanism.

As discussed above, the materiality of the risk faced by retailers due to COVID-19 will differ between participants. The Commission therefore considers it is appropriate to consider limiting access to the financial support provided by the proposed deferral mechanism to those retailers that have a demonstrable need for this support as a direct result of the COVID-19 pandemic. If this approach is not taken, the AER's proposal could result in financially stable retailers receiving a cash flow benefit in the form of deferred network charges despite not facing any imminent financial risk. It may also substantially increase the materiality of the cash-flow burden that DNSPs are required to take on. This is discussed further in section 4.4.

Options for how access to the deferral mechanism may be determined include:

- **Excluding certain retailers from deferring the payment of network charges:**
  - Retailers that are considered to be in a strong financial position or able to access alternative sources of credit could be expressly excluded from accessing the deferral mechanism on the basis that these retailers should have the capacity to absorb and manage the financial impacts of COVID-19 without resorting to this mechanism. This could include, for example, large retailers with strong balance sheets, RoLR retailers or government owned retailers.

- However, the Commission notes that, while the risk may be lower than for other retailers, there remains a possibility that retailers falling into the aforementioned categories could face unexpected or unmanageable financial distress in the short-term. The risk of such distress causing the failure of a large retailer, which could have significant consequences for the market as a whole, may be heightened if that retailer were expressly excluded from accessing the cash flow relief provided by the proposed deferral mechanism.

- **Imposing appropriate preconditions on retailers' ability to defer the payment of network charges:**
  - This approach would place the onus on retailers to demonstrate a legitimate need for the financial support provided by the deferral mechanism as a result of COVID-19.
  - This may include, for example, establishing criteria for accessing the deferral mechanism which relate to the financial position of retailers seeking support. Retailers would need to substantiate that they meet these criteria to be eligible to defer the payment of network charges for relevant customers. This approach would likely require some form of independent verification of retailers' eligibility. The Commission considers that the AER would likely be the most appropriate body to undertake this verification function.
  - A similar approach has been adopted by the New Zealand Electricity Authority, which has recently announced an urgent amendment to the *Electricity Industry Participation Code 2010* to provide immediate financial relief to retailers by allowing them to defer the payment of distribution network charges for 60 days. Further information on the New Zealand scheme, including the eligibility requirements for retailers, is set out in Box 2.
- **Designing the deferral mechanism in a way that imposes appropriate incentives on retailers:**
  - As a design principle, it may be preferable for retailers to only resort to deferring the payment of network charges as a means of cash flow relief where the retailer is unable to obtain credit from market sources.
  - A simple way of achieving this would be to impose an interest rate on deferred network charges. It is expected that during the COVID-19 crisis, large financially stable retailers will still be able to secure market funding, whereas smaller or more financially vulnerable retailers may face issues accessing credit in this manner.
  - The level at which an interest rate on deferred network charges is set could therefore influence which retailers choose to use the deferral mechanism to alleviate their cash flow issues. Retailers that have credit ratings which allow them to access financing at an interest rate lower than the rate applying to deferred network charges would have a financial incentive to try to secure credit from the market. On the other hand, the interest rate applying to deferred network charges may be favourable for retailers with lower credit ratings (i.e. retailers that can only secure credit at higher interest rates) who are likely to have a legitimate need for this source of cash flow relief.

- This approach could negate the need for eligibility criteria (as discussed above) as retailers would decide whether to access the deferral mechanism having regard to their own financial incentives and risk appetite. This may also reduce the administrative burden of this process and allow payment deferrals to be facilitated in a more timely manner, as there would be no need for independent verification of information provided by retailers to establish their eligibility.
- Under this approach, there would be trade-offs to consider in setting the interest rate at an appropriate level which provides the right incentives to retailers. Consideration may also be given to what rate is appropriate to allow NSPs to recover their efficient costs incurred as a result of the deferral of these payments, which is discussed further in section 4.4.

### BOX 2: NEW ZEALAND ELECTRICITY INDUSTRY PARTICIPATION CODE AMENDMENT

The New Zealand Electricity Authority (the Authority) recently announced an urgent amendment to the *Electricity Industry Participation Code 2010* (the Code) to assist retailers by providing them with an additional 60 days to pay distribution network charges to the six largest DNSPs for a period of up to nine months.

The Authority has noted that this support is not intended to apply to:

- Retailers that were already in financial difficulty before the COVID-19 pandemic, where support is likely to simply result in more unpaid debt within the sector
- Retailers that are already able to access the financial support they need. This includes retailers that are part of a publicly listed group, and retailers that have access to sufficient capacity to provide additional capital or loans to successfully manage new overdue debts.

As such, in order to access the New Zealand scheme a retailer must establish that it:

- was financially sound prior to COVID-19
- has been materially impacted by additional doubtful debt as a result of the impact of the COVID-19 lockdown in New Zealand
- cannot cover this impact through other facilities or support from shareholders.

The Commission understands that the specific criteria proposed for this scheme includes:

- the value of the retailer's overdue payments in a month is at least 25% greater than:
  - the retailer's overdue payments in the same month in 2019; or
  - if the retailer was not trading in the same month in 2019, or their revenue has increased by more than 25% since the same month in 2019, the retailer's overdue payments in March 2020; and
- the retailer has, or in the next 6 months immediately following the date of the certificate is likely to have, significant liquidity problems; and
- the liquidity problems are, or will be, a result of the effects of COVID-19; and

- the retailer is considered solvent under New Zealand legislation; and
- it is more likely than not that the retailer will be able to pay its due debts within 12 months.

The financial position of retailers applying for the scheme will be independently certified, and a report provided to the Authority to advise whether or not to include them in the scheme.

It is also proposed that distributors would be restricted from changing the prudential security required from qualifying retailers during the period the changes are in force.

Source: New Zealand Electricity Authority, *COVID-19 - Authority updates*, May 2020. For more information see: https://www.ea.govt.nz/about-us/media-and-publications/covid-19/authority-update/httpswww-ea-govt-nzabout-usmedia-and-publicationscovid-19authority-updatemay-2020/.

The Commission is interested in stakeholder views on:

- appropriate preconditions and incentives which could be imposed on retailers in the NEM seeking to access the proposed deferral mechanism
- information retailers could be required to provide to substantiate that they meet these preconditions.

### QUESTION 2: RETAILER ELIGIBILITY

(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.

(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?

(c) What would be an appropriate and efficient process for the verification of information provided by retailers under the approach described in (b) above?

(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)?

(e) Do stakeholders have views on whether any of the approaches outlined above (or a combination of each) would be preferable?

**Customer eligibility**

As discussed in section 2.2.1, the AER has proposed that retailers be able to defer the payment of network charges incurred in respect of customers that enter into one of the following arrangements between 1 March 2020 and 31 December 2020:

- a payment plan or instalment arrangement
- any arrangement as a hardship customer

- any deferred debt arrangement.

This is intended to capture customers whose ability to pay their electricity bill has been compromised by the impacts of COVID-19. The Commission notes that only small customers would be captured by the reference to hardship customers and customers on a payment plan or instalment arrangement. However, the AER's proposed definition of "deferred debt arrangement" is quite broad and could capture large customers on such arrangements.

The Commission intends to consider which customers the deferral mechanism should apply to and how this can be clearly defined in the NER. A key question would be whether retailers should be able to defer the payment of network charges incurred in respect of large commercial and industrial customers. While some large customers may also be facing financial difficulty due to COVID-19, the Commission notes that the AER's Statement of Expectations does not restrict retailers from disconnecting large customers for non-payment (except where that customer is on-selling energy to residential or small business customers, for example in residential parks or retirement villages). Retailers are also more likely to hold security which they can draw on in the event of non-payment by large customers, reducing the cash flow impact and associated risk to the retailer. The Commission notes that the existing Network Relief Package only applies to residential and small business customers.

### 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?

### 4.2.2 Deferral timeframe and terms

#### Initial deferral period

The AER has proposed that the payment of relevant network charges be deferred for a period of six months and apply to charges incurred between 1 July 2020 and 31 December 2020. We understand that this is based on the AER's reasonable expectation of when the impacts of COVID-19 and the associated financial pressure on electricity customers (and by extension retailers) may begin to subside.

Given that the economic and social impacts of COVID-19 are continuing to evolve, it is difficult to predict with certainty what the financial implications will be for retailers in the second half of 2020. However, current indications are that the adverse impacts on the Australian economy, including increased unemployment, will continue to be felt through to the end of 2021.[14]

It is possible that the need amongst retailers for the financial support provided by the proposed deferral mechanism could subside several months before the end of 2020, in which

14 Reserve Bank of Australia, *Statement by Philip Lowe, Governor: Monetary Policy Decision*, 5 May 2020, Media Release.

case a six-month deferral period may be longer than is strictly necessary. However, this may be preferable to an alternative scenario where the deferral period is set too short (i.e. before the retail market is in a strong position to withstand the economic impacts of COVID-19), in which case the risk of financial contagion in the NEM could re-materialise once the deferral mechanism ceases to operate.

The Commission is interested in stakeholder views on what may be an appropriate deferral period for the payment of network charges, having regard to both the likely impacts of COVID-19 on the energy sector in the coming months and the cash flow impacts of the proposed deferral mechanism on NSPs.

### QUESTION 4: LENGTH OF DEFERRAL PERIOD

(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?

(b) What are the implications (if any) of a six-month deferral period for NSPs, compared to a shorter or longer deferral period?

**Extension of deferral period**

The AER's proposed rule change would confer the power on the AER to extend the period in which retailers are able to defer the payment of network charges beyond 31 December 2020 if it considers it reasonably necessary to do so. Given the uncertainty about how the impacts of COVID-19 may continue to manifest over the next six to twelve months, it may become evident towards the end of 2020 that it is necessary to extend the deferral period under the proposed rule change to provide ongoing support to retailers that are continuing to experience cash flow impacts. However, the Commission acknowledges that this could introduce additional uncertainty for DNSPs about how long the proposed deferral mechanism would continue to impact on their cash flows. In addition, it would be important that any decision to extend the deferral period is based on consideration of the circumstances of market participants and the extent to which the deferral mechanism is still necessary. This could be achieved by requiring the AER to apply transparent criteria to any such decision-making process.

The Commission is interested in stakeholder views on the potential for the deferral period to be extended if necessary and the process which should apply to any such decision.

### QUESTION 5: EXTENSION OF DEFERRAL PERIOD

(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?

### 4.2.3 Deferral of payments between DNSPs and TNSPs

The AER's rule change request suggests that if retailers are permitted to defer the payment of network charges to DNSPs, DNSPs would in turn withhold a reasonable portion of their payments of transmission charges to TNSPs. The Commission understands the intention of this proposal is to allow the impact of the proposed rule change to be shared across all network businesses. The rule change request does not detail how the deferral of payments from DNSPs to TNSPs would work in practice and the proposed rule drafting provided by the AER does not address this issue.

This is a complex issue which may require consideration of a range of policy issues and potentially substantive changes to the NER to implement. For example, this would mean if a retailer defaulted on the deferred network payments to the DNSP, arrangements would need to be in place for both the DNSP and TNSP to recoup the defaulted payments, rather than just the DNSP. The Commission is therefore interested in the views of stakeholders, particularly NSPs, on the merits of allowing DNSPs to defer payments to TNSPs.

QUESTION 6: DEFERRAL OF PAYMENT OF TRANSMISSION NETWORK CHARGES

(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?

(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?

## 4.3 Practical implementation of payment deferrals

The AER's rule change request does not propose a specific process to facilitate the deferral of payments of network charges in practice. Should a deferral mechanism be implemented, it would be important to ensure that retailers and DNSPs are able to identify eligible retailers and/or customers and agree on payment deferrals for those customers in accordance with a clear and efficient process. This will reduce the scope for disputes or miscommunication which could delay retailers being able to access cash flow relief in a timely manner, which is the key objective of the proposal.

The Commission would need to consider a number of issues in relation to the process for deferring the payment of network charges, including:

- the steps which may be required to verify that retailers are only seeking payment deferrals from NSPs for eligible customers while still ensuring that the deferral process can be administered efficiently
- whether it is appropriate and/or practical for the details of this process to be prescribed in the NER and, if not, any viable alternative approaches for determining this process.

While the NER may include high-level principles relating to the deferral process, it is unlikely to be practical for the details of this process to be comprehensively set out in the NER. Such an approach could reduce the flexibility that is likely to be needed for retailers and NSPs to agree on how to best facilitate payment deferrals.

The Commission is aware that retailers and NSPs in some NEM regions have agreed on processes for implementing the measures set out in the Network Relief Package announced by Energy Networks Australia (ENA) in April 2020, which includes the deferral of the payment of network charges for certain customers. Given that these processes would already be in place by the time any final rule commences, the Commission may consider the extent to which the proposed deferral mechanism could leverage these existing processes (along with other alternative options for prescribing the details of the deferral process).

QUESTION 7: PROCESS FOR DEFERRING PAYMENT OF NETWORK CHARGES

(a) Do stakeholders have views on appropriate processes which could be adopted to facilitate the proposed payment deferrals in an expedient manner?

(b) Could the processes agreed between retailers and NSPs for implementing the Network Relief Package also be used to implement the AER's proposal?

(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?

## 4.4 Impact on NSPs

The AER's rule change proposal would not reduce the total revenue recoverable by NSPs over time and is not intended to change the allocation of risk between retailers and NSPs. NSPs would remain entitled to recover the full amount of revenue determined by the AER under its regulatory determinations. In addition, retailers would be obliged to pay any deferred network charges at the end of the deferral period regardless of whether the retailer has been paid by the relevant customer. The retailer would therefore continue to bear the risk of any bad or doubtful debts at the end of this period.

DNSPs are required to submit an annual pricing proposal to the AER outlining proposed prices to take effect from the commencement of the next regulatory year. This process provides DNSPs with an opportunity to adjust their network charges each year so that they recover their allowed revenues as determined by the AER through the regulatory determination processes. Adjustments to network tariff pricing levels can reflect changes in relevant inputs, including adjustments to the annual revenue allowance to account for any overs/unders. The Commission understands that this process may allow an under-recovery of revenue by NSPs in one year as a result of the deferred payment of network charges to be recovered in the following year. The Commission is interested in DNSPs' views on this issue.

The Commission acknowledges that while the proposed deferral mechanism would not reduce the total revenue recoverable by NSPs, it would have an impact on NSPs' cash flows in the short-term. The AER does not anticipate in its rule change request that this would pose a material risk to NSPs. Given their position as relatively low-risk utilities with regulated returns, there is an assumption that efficient network businesses should be able to secure additional credit to manage these cash flow impacts if needed (and should therefore be in a strong position to absorb any such impacts in the short-term). This reasoning may support the view that it is appropriate and pragmatic for NSPs to share the cash flow impact that COVID-19 is having on the energy sector.

The Commission is therefore interested in understanding the extent to which NSPs consider that the cash flow impacts of the proposed deferral mechanism would impose an unmanageable financial risk on their business. This may include, for example, credit rating risks or challenges borrowing funds in the current economic environment. Financial information or analysis NSPs are able to provide in this regard would assist the Commission's consideration of this issue. To the extent there is considered to be unmanageable financial risk the Commission is also interested in receiving input on how those could be effectively managed through the design of the mechanism.

The AER's rule change request also notes some options for allowing NSPs to recover the efficient costs they may incur as a result of the payment deferrals (i.e. borrowing costs). The Commission considers this would be consistent with the intention that the deferral mechanism not result in additional risk being transferred to NSPs. The simplest approach under the existing regulatory framework would be to require retailers to pay interest on any deferred network charges. This would require consideration of how the interest rate could be set at a level which is likely to appropriately reimburse NSPs for their efficient costs. The regulated weighted average cost of capital (WACC) may be appropriate for this purpose, given that the WACC is intended to take into account the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to an NSP providing the services covered by the NER. As discussed in section 4.2.1, charging interest on deferred network charges could also provide incentives for certain retailers to not utilise the deferral mechanism, depending on their level of access to alternative sources of credit. As such, the Commission considers that this approach could achieve the dual objectives of reimbursing NSPs for their efficient costs and providing the right financial incentives to retailers seeking to access the mechanism. The Commission would need to consider how the interest rate could be set at a level which facilitates both of these objectives.

### QUESTION 8: IMPACT OF PROPOSED DEFERRAL MECHANISM ON NSPS

(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?

(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?

(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?

(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?

# 5 PROCESS FOR THIS RULE CHANGE

## 5.1 Treatment as an urgent rule

The AER has proposed the rule change request be treated as urgent in accordance with s. 96 of the NEL such that it could be processed on an expedited basis. This request has been made on the basis that electricity retailers are facing an imminent risk of incurring ongoing costs without matching revenue streams to meet those costs as a result of the unprecedented impact of the COVID-19 pandemic on customers' ability to pay their power bills. While other support measures have been made available by governments and industry participants, the AER considers that it is prudent and reasonable to take appropriate additional steps at this point in time to mitigate the risk of multiple retailer failures in the short term.

The Commission considers that the rule change request should be subject to the expedited rule making process under s. 96 of the NEL on the grounds that it considers the rule change request to be for an urgent rule.[15] More specifically, the Commission considers that if the rule change request is not considered as quickly as possible the effective operation and administration of the wholesale electricity market would be imminently prejudiced or threatened. This is because the economic impact of COVID-19 threatens the financial viability of many participants and potentially in turn the financial resilience of the energy industry. Furthermore, there is evidence that this impact could be reduced if the obligation on retailers to pay network charges incurred during this period is deferred as soon as possible.

The Commission's view has been informed by a number of factors, including:

- **The COVID-19 pandemic has caused a severe economic downturn.** The Reserve Bank of Australia (RBA) notes that the global economy is experiencing a severe downturn as countries seek to contain the coronavirus and the Australian economy is going through a very difficult period.[16]
- **There has been a material decrease in Australian total wages and employment.** The Australian Bureau of Statistics (ABS) showed that:
  - between 14 March and 18 April 2020, employee jobs decreased by 7.5% and total wages paid decreased by 8.2% in Australia.[17]
  - nearly a third of Australians (31%) reported that their household finances had worsened due to COVID-19[18]

15 An 'urgent rule' is defined in section 87 of the NEL as "a rule relating to any matter or thing that, if not made as a matter of urgency, will result in that matter or thing imminently prejudicing or threatening: (a) the effective operation or administration of the wholesale exchange operated and administered by AEMO; or (b) the safety, security or reliability of the national electricity system".

16 Reserve Bank of Australia, *Statement by Philip Lowe, Governor: Monetary Policy Decision*, 5 May 2020, Media Release.

17 Australian Bureau of Statistics, *6160.0.55.001 - Weekly Payroll jobs and wages in Australia, week ending 18 April 2020*, 5 May 2020. Available at: https://www.abs.gov.au/ausstats/abs@.nsf/mf/6160.0.55.001.

18 Australian Bureau of Statistics, 4940.0 - Household Impacts of COVID-19 Survey, 14-17 Apr 2020, 1 May 2020. Available at: https://www.abs.gov.au/AUSSTATS/abs@.nsf/allprimarymainfeatures/86FF043DD0C1A1B8CA25856B0081D6F7?opendocument.

- eight percent of Australians aged 18 years and over reported that their household was unable to pay one or more selected bills on time over the period mid-March to mid-April due to a shortage of money.[19]
- The RBA's baseline scenario is for the Australian unemployment rate to peak at around 10 per cent over the coming months and remain above seven per cent at the end of 2021.[20] These adverse economic conditions are likely to reduce the ability of households and businesses to pay their bills, including for electricity, as explained further below.

- **The potential for a material reduction in revenues may cause financial stress for retailers and financial contagion in the energy sector.**
  - The AER notes that many people are or will be affected by the dramatic changes to their lives, businesses, income and working arrangements and that customer's ability to pay their bills may in turn be affected.[21]
  - Electricity retailers have relatively low margins (NEM average earnings before interest, depreciation and amortisation (EBITDA) was four per cent in 2018-19 or $66 per residential customer)[22] meaning they have a narrow financial buffer to manage the risks and wholesale volatility of the industry. Additionally, smaller retailers that play an important role in keeping the market competitive have high 'costs to serve' (65 percent higher than Tier 1 retailers) and 'costs to acquire and retain' customers (93 per cent higher than Tier 1 retailers) than larger retailers making them vulnerable to material increases in customer non-payment of bills, which reduces revenues and negatively impacts cash flows.[23]
  - Retailers carry the cash flow and credit risk for the energy industry value chain. As a reference, in November 2019 the ACCC found that for every $100 received by or owed to retailers from customers, $43 is payable to networks, $33 for wholesale electricity costs, and $8 to environmental scheme costs. Of the remainder, $11 covers retailer costs, leaving $4 of retail margin.[24] Given this, a relatively small increase in customer non-payment can result in retailers experiencing negative cash flows, which may threaten their viability and have consequent financial impacts across the industry value chain.
  - This is exacerbated by the fact that retailers do not currently have the option of disconnecting customers for non-payment in the short term, including where these customers have been transferred to the retailer as a result of a RoLR event.

19 Ibid.
20 Reserve Bank of Australia, *Statement by Philip Lowe, Governor: Monetary Policy Decision*, 5 May 2020, Media Release.
21 AER Statement of Expectations of energy businesses: Protecting consumers and the market during COVID-19, 9 April 2020.
22 ACCC, Inquiry into the National Electricity Market, November 2019 report, pp. 4-6.
23 Ibid, pp. 73-77.
24 Ibid, p. 30.

- **The design of the RoLR scheme does not provide the flexibility required to manage the impacts on the retail market of successive retailer failures in the short term.**[25] The Commission is therefore concerned that the triggering of a number of RoLR events could lead to financial contagion in the NEM, potentially resulting in cascading failures of electricity retailers.
- **The failure of multiple retailers in the short term is likely to have negative long term impacts on the structure of the retail electricity market.** In particular, this outcome could significantly reduce competition in the retail market, which would lead to sub-optimal outcomes for consumers and could damage consumer confidence in the retail market. Should this occur, it could potentially take years for the current level of competition in the retail market to be restored.
- **The benefits of any final rule would be significantly reduced if the rule change were subject to the standard rule-making process.** The proposed rule change could not apply retrospectively, meaning a final rule which defers retailers' obligation to pay network charges would only apply to statements of charges issued after the commencement date of the final rule. If the standard rule-making process were followed instead of the expedited process, this would delay the commencement of any final rule by several months. In this scenario, any final rule allowing for the deferral of payments would likely commence too late to be of significant benefit in alleviating the cash flow pressure on financially vulnerable retailers.

Rule changes that are considered to be urgent may be processed under an expedited (faster) process under which there is only one round of consultation and the AEMC is required to publish its final rule determination within eight weeks of commencing the rule change process.[26]

The Commission has decided to use an expedited process to consider this rule change request provided that it does not receive any valid requests not to use the expedited process by 11 June 2020. To be valid, an objection should set out the reasons why the AEMC should not make a rule in accordance with the expedited process, and accordingly, that the rule change request is not a request for an "urgent rule" as defined in s.87 of the NEL. If the Commission receives a valid objection, it must revert to the standard rule making process for this rule change.

The Commission strongly encourages stakeholders to contact Mitch Shannon on (02) 8296 0639 or mitchell.shannon@aemc.gov.au, or Ben Davis on (02) 8296 7851 or ben.davis@aemc.gov.au, prior to lodging an objection.

The Commission notes that, if the rule change is progressed under the expedited process:

- it would not be possible for the rule to commence on 1 July 2020 as proposed by the AER due to the statutory consultation timeframes under the NEL

25 The Commission recommended a number of changes to the RoLR scheme in its final report for the NEM financial market resilience review in 2015. The Commission has not received a rule change request to implement these changes to date.

26 The AEMC has published a notice under ss. 95 and 96 of the National Electricity Law to commence and assess this rule change request as an urgent rule.

- a final determination and final rule would be published on 23 July 2020 (subject to any extension under section 107 of the NEL).

## 5.2 Application in Victoria

The AER's rule change request proposes changes to Chapter 6B of the NER to facilitate the deferral of network charges. The Commission notes that Chapter 6B of the NER has not been adopted in Victoria. As such, the proposed rule change would not apply to network charges incurred by retailers in Victoria. The Commission understands that the Victorian Government will monitor this rule change process and consider whether any equivalent regulatory changes are required in Victoria.

# 6 LODGING A SUBMISSION

The Commission invites requests not to make a rule under the expedited process and written submissions on this rule change proposal.

All enquiries on this project should be addressed to Mitch Shannon on (02) 8296 0639 or mitchell.shannon@aemc.gov.au.

## 6.1 Lodging a request not to make a rule under an expedited process

Written requests not to make a rule under the expedited process in s. 96 of the NEL must include reasons for the request, and must be lodged with the Commission by 11 June 2020 online in accordance with the process specified below.

## 6.2 Lodging a submission to this rule change request

Written submissions on the rule change request must be lodged with Commission by 25 June 2020 online in accordance with the process specified below.

Where practicable, submissions should be prepared in accordance with the Commission's guidelines for making written submissions on rule change requests.[27] The Commission publishes all submissions on its website, subject to a claim of confidentiality.

## 6.3 Lodging online

Submissions, or requests not to make a rule under the expedited process, must be lodged online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code ERC0302.

The request or submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

27 This guideline is available on the Commission's website www.aemc.gov.au.

# ABBREVIATIONS

| | |
|---|---|
| ABC | Australian Bureau of Statistics |
| ACCC | Australian Competition and Consumer Commission |
| AEMC | Australian Energy Market Commission |
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| Commission | See AEMC |
| ENA | Ministerial Council on Energy |
| NEL | National Electricity Law |
| NEM | national electricity market |
| NEO | National electricity objective |
| NERL | National Energy Retail Law |
| NSP | network service provider |
| RBA | Reserve Bank of Australia |
| RoLR | Retailer of Last Resort |
| WACC | weighted average cost of capital |