AUSTRALIAN
ENERGY
COUNCIL

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ERC0302 – Deferral of network charges Consultation Paper

The Australian Energy Council welcomes the opportunity to make a submission to the AEMC Consultation Paper on the proposed Deferral of Network Charges Rule Change (the Consultation Paper).

The Australian Energy Council (AEC) is the industry body representing 24 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The AEC supports the Australian Energy Regulator's (the Proponent) proposed rule change 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 for six months. The Proponent highlights in its Rule Change Request that the proposed rule is intended to support the resilience of retailers adversely affected by the COVID-19 pandemic and minimise risks of financial contagion within the sector. The AEC supports this contention, noting in particular the long-term impacts on customers if retailers in the competitive market are unable to continue meeting their obligations in the National Electricity Market due to circumstances outside of their control.

As such, the AEC considers a carefully crafted rule may enable retailers affected by significant additional non-payment to meet their obligations in the NEM, and avoid triggering the Retailer of Last Resort (RoLR) mechanisms in the National Energy Retail Law. In these very narrow circumstances, the AEC does not consider a targeted and timebound rule such as the one proposed would increase risks faced by network businesses, and thus is unlikely to result in long term detriments to consumers.

However, the AEC does not consider this rule change in any way mitigates the significant additional risks placed on retailers by the Government's response to the COVID-19 pandemic. Retailers remain responsible for managing the entire non-payment risk in the NEM, even though the AER's Statement of Expectations (SoE) limits their ability to collect customer debts. Given that, this rule change proposal, while welcomed, cannot be considered to be a panacea for ensuring competitive retail markets in the future – it merely makes it less likely that retailers will trigger the RoLR provisions in the coming months.

The problem faced by retailers

As noted by the AEMC in the Consultation Paper, electricity retailers carry the credit and cash-flow risk for the entire supply chain. The AEC agrees with the AEMC that all else being equal, risks should generally sit with the participant best able to manage them. Given retailers hold the customer relationship, they are in the best position to ensure their individual customers pay their bills.

But the COVID-19 pandemic, and the Government's response, has been unprecedented. Retailers have been told by the regulator to expand upon its hardship and customer assistance programs, and not to undertake any disconnections for non-payment without customer consent. These obligations create

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viability questions for retailers expected to be able to make a fair return for carrying the credit and cash-flow risk for the entire supply chain.

The AER's SoE was published on 29 March 2020. It is currently in place until at least 31 July 2020. During this period retailers have worked hard to continue to engage and support their customers, but the enhanced customer protections in the SoE has resulted in retailers holding greater debts than they otherwise would. So as to understand the quantum of this impact, it is worthwhile to consider the counterfactual – that is, what would have otherwise occurred had it not been for the SoE.

In 2018/19 retailers undertook 76,538 electricity disconnections in the NECF states[1]. This equates to a simple average of approximately 6380 disconnections per month. If this monthly rate remained constant between 1 April and 31 July 2020, it could be said that approximately 25,500 customers have not been disconnected that otherwise would. Given retailers are only allowed to disconnect small customers as a last resort, it would appear that the vast majority of these customers might have disengaged from their retailers' offers of hardship and other support. Given the economic impacts of COVID-19, and the significant increase in unemployment, it could be assumed that more disconnections for non-payment would have occurred between April and July than the corresponding period in the previous year.

Whilst the AEC is not able to infer the outcomes for individual customers that have not been disconnected during the COVID-19 pandemic, what is clear is that retailers are likely incurring significant debts the regulatory framework intended them to be able to avoid.

In addition, the AER's SoE extended existing support measures such as hardship and payment plans to any small business customer eligible for the Federal Government's JobKeeper stimulus. By the Government's own reckoning, some 768,000 businesses have enrolled to receive the JobKeeper payment. While the percentage of these businesses that would be classified as small by the National Energy Retail Law is unclear, it is likely that retailers are now required to provide financial support to a very significant number of business customers – again, support the existing regulatory framework does not account for.

Of greatest concern to the AEC is the impact of this additional support provided on a retailer's ability to recover these debts in the long term. It seems clear that at least a percentage of customers who have been protected by the AER's SoE will not repay their debt in full and will need to be written off. The exact scope of this non-payment cannot be predicted until the full extent of the pandemic, and the flow on impacts to the economy are known.

Support provided to date

In early April 2020, Energy Networks Australia announced its Network Relief Package. The ENA package intended to support impacted customers in NSW, Victoria and South Australia. In practice, the package waived network costs for some small business customers who had shutdown or gone into hibernation during the April to June quarter.

For residential customers, the ENA package provided some cash flow relief to retailers in circumstances where a customer had lost their jobs due to the impacts of the pandemic.

While welcomed, the AEC does not consider this assistance was proportionate to the impost the SoE placed on retailers. For small business customers hibernating (that is, consuming less than 25% of their usual consumption during the period), the waiver of the network bill was beneficial – meaning demand charges that don't vary based on consumption levels could be avoided. But, for the vast majority of businesses that

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[1] AER Retail Markets Report 2018/19, Pg 81-86

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retailers were required to assist under the statement of expectations, the ENA package is unlikely to provide any assistance to retailers[2].

Proportionate and targeted assistance
As noted above, the Government's response to the pandemic has resulted in two key challenges for retailers.

The first requires retailers to maintain liquidity so as to continue to meet their obligations to the market in an environment where customer payments are likely to be delayed. This challenge can be categorised as cash flow risk.

The second challenge is for retailers to reduce non-payment in the medium term to a level that allows it to make a fair margin (or indeed, any margin at all), for the services they provide their customers and the market. For a low margin, high cost business like electricity retail, this challenge can be categorised as viability risk.

The AER's proposed rule change only considers cash flow risk – it does nothing to mitigate upstream costs, or reduce non-payment caused by interventions in the retail market. In effect, unless a customer who doesn't pay immediately pays before 31 December, the proposed rule change will not provide any benefit to a retailer unable to meet its obligations to the market. In short, it is likely the retailer who could not pay its debts before 31 December 2020, will still not be able to pay those debts after 1 January 2021. In this scenario, the rule change could be considered to only mitigate the risk of RoLR events in 2020 – it does nothing to avoid them in the future.

To that end, if a retailer is cash poor, the rule change might enable them to continue to function long enough to repair its liquidity to a manageable level. For all other retailers, the rule change is likely to be of little long-term benefit.

The AEC understands that a rule change of this nature has the potential to increase the costs for consumers in the long term, particularly if non-payment risk was passed onto monopoly network assets. The AEC does not consider this would be a worthwhile outcome when considered against the benefits the Proponents seek to deliver. That being said, we do not accept that this rule change places any material risks onto retailers that might warrant a change in the cost of capital the existing regime allows. Network businesses will continue to be able to collect the same revenues as they otherwise would, albeit that they would receive them slightly later in the financial year.

Appropriate allocation of risks
As is the case with the existing regulatory framework, the AEC considers that risks from COVID-19 should be placed with market participant best able to mitigate them. Outside of a pandemic, a retailer is able to mitigate the risk of non-payment through collection activities ultimately culminating in disconnection for a customer who does not pay. However, at this time the AER's SoE prohibits a retailer from disconnecting any customer in financial stress, whether or not the customer in engaging with their retailer or receiving support under their hardship program. In effect, the SoE creates an opt-out hardship framework, where customers (including unknown occupier customers) cannot be disconnected even if they fail to respond to any retailer attempts of engagement. In this environment, a retailer is unable to mitigate the risks of non-payment, and thus, consideration needs to be given to transferring this risk to a party that can.

[2] Anecdotally, some network businesses in Victoria have advised that only 5% of their small business customers were eligible for the ENA package – far below the expected 15% eligibility.

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The AEC considers that regulated network businesses represent the party best able to manage this risk. As highlighted by the AEMC in the Consultation Paper, network businesses operate under a revenue cap, with customers committed to paying a set amount over a 5 year regulatory period. The existing regulatory framework includes mechanisms for network businesses to recoup any shortfalls in revenue in a previous period. This concept is not incongruous with the proponents rule change request. If a retailer utilises the deferral capability and underpays in a given year, the network will be able to recover the amounts in a future year. In this context, the network seems best able to manage the risks of late payment, and therefore if payment deferral is deemed in the long term interests of consumers, then it should be the network rather than some other participant in the supply chain that bears the cost of such a deferral.

Retailer Eligibility

The Consultation Paper raises a number of questions about the scope of any potential rule, in particular, whether there is a need to limit the operation of any rule to a particular subset of retailers.

The AEC does not support rules that differentiate between participants by class. In times of crisis, simply because a retailer is large or has other particular characteristics does not mean they will be immune to the impacts of that crisis. Whilst it appears unlikely at this time that large retailers will need to the type of cashflow support the proposed rule will deliver, should the pandemic worsen significantly (either the health impacts itself, or the broader economic impacts caused by the pandemic) in the coming months, precluding support to categories of retailers may fail to deliver the intent of the rule.

Similarly, placing obligations on retailers to prove a legitimate financial need is likely to place an administrative burden on market participants for little additional value.

The AEC considers a better approach to implementing the proposed rule would be to incentivise retailers to only seek deferral of network payments when they genuinely need to. This would then avoid any risk that retailers might unnecessarily utilise the facility, and mitigate likely arguments from opponents to the proposed rule that the costs of administering the scheme would be prohibitive, and ultimately lead to increased customer bills.

However, it is important that any mechanisms developed in a more preferable rule do not result in increased costs to energy users. There is a risk that an imposition of interest charges over and above the genuine cost a network will face from the rule will increase costs in the system, without any commensurate benefits. Instead, the AEC considers a minimal interest charge might achieve the outcome sought by the proponents, whilst mitigating any increased costs. Given networks operate under a revenue cap, any additional interest received would ultimately need to be reflected in future years, so there is benefit in mitigating that to the extent possible.

That being said, if there are any efficient costs to delivering the deferral rule change, as a matter of principle the AEC considers these costs should be paid by the retailer utilising the service on a user pays basis.

Customer eligibility

The AEC does not consider there is any incremental benefit to narrowly limiting the application of this rule to customers who first encountered payment difficulty during the COVID pandemic. As was found when retailers and networks were seeking to implement the ENA's support package, there are practical challenges to identifying the cause of a customer's payment difficulties. Given this, limitations on the rule should only be implemented if they better deliver the policy intent.

In this instance, the policy intent of the Proponent is to allow retailers who have been impacted by cash flow risk caused by the COVID pandemic to defer a percentage of their network costs until 1 January 2021.

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In this instance, customers impacted by COVID-19 will not be readily identifiable by their characteristics, and certainly not in a manner able to be registered within the market systems. To this end, if the rule was applied narrowly, retailers would need to record within their systems whether or not the customer is COVID impacted, and prove this to the network utilising a mechanism outside of existing processes. This would be administratively burdensome – increasing costs for little benefit.

An alternative approach would be to simply apply the rule to any customer who is currently on a payment plan or in a retailer's hardship program, irrespective of when that customer notified the retailer that they were unable to pay their energy bills. This data (as a total count) is provided to the AER as part of performance reporting, with the AER publishing this data (by retailer) periodically. To this end, the network will be able to confirm the number of customers the retailer has advised is eligible by cross checking with publicly available information, rather than requiring retailers to 'prove' customer eligibility through a mechanism specifically developed for this rule.

Length of deferral period

The AEC considers that a 6 month deferral is appropriate. Under the existing RoLR obligations, any outstanding network debts a failed retailer holds at the time of the RoLR event will be recovered by all customers in a future year through the 'overs and unders' mechanism. This is clearly suboptimal, and should be avoided wherever possible.

In this rule change, the AER only intends to defer network costs so as to mitigate the risk of RoLR events during a pandemic, rather than to socialise a failing retailers non-payment risk. In this context, it is important that the mechanism itself does not enable a failing retail business to continue to operate in an environment where it is unable to afford its network costs (as opposed to being unable to pay its network costs in the short term due to cash flow risk).

Given this risk, the AEC considers that a deferral longer than 6 months may result in risks to the stability of the market – particularly in circumstances where a number of retailers are deferring costs for a long period. Given the narrow application of this rule change proposal, it is important that the solution does not result in higher risks than benefits.

In closing, the AEC reiterates its support for this rule change, and welcomes the proponent's consideration of the challenges facing retailers during the pandemic. However, the AEC does not consider the rule change provides any benefits to retailers exposed to non-payment risks caused by factors outside their control, and further work is needed to ensure the regulatory framework appropriately allows a retailer to cover its costs. The AEC would welcome the opportunity to discuss with the AEMC and policy makers further approaches that might better compensate retailers for the services they are required to provide the market at this time – including whether or not there are appropriate mechanisms to share these unavoidable costs between other market participants.

For any questions about our submission please contact me by email at ben.barnes@energycouncil.com.au or on (03) 9205 3115.

Yours sincerely,

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