

24 June 2020

Australian Energy Market Commission  
Project ERC0302

Submitted via the Commission's website: [aemc.gov.au](http://aemc.gov.au)

## **Re: Response to Consultation Paper on Deferral of Network Charges Rule Change**

Spark Infrastructure has interests in some \$18 billion of electricity network assets, delivering energy to more than 5 million customers across the National Electricity Market (**NEM**). These interests include a 15% interest in TransGrid, the electricity transmission network in NSW; a 49% interest in SA Power Networks, the electricity distribution network in South Australia; a 49% interest in both CitiPower and Powercor, two of the electricity distribution networks in Victoria; and 100% ownership of the Bomen Solar Farm in NSW.

We are concerned that this rule, as proposed, may not be effective and will impose additional costs on customers. In addition, the making of this rule would further blur the roles and responsibilities of regulators and policy makers.

### **COVID-19 and related support measures**

The COVID-19 global pandemic and economic crisis has had an unprecedented impact on all Australians. We commend the Australian Government on its response to the COVID-19 challenges through its industry and social support packages, as well as its leadership in encouraging all Australians to work together through these difficult times. The Australian Government's role in supporting households and businesses has to date reduced the overall impact of the crisis and will put us in good stead for a more rapid recovery.

Privately owned electricity networks in New South Wales, Victoria and South Australia have previously announced a range of measures to support customers facing hardship during these unprecedented times. This is on top of the customer hardship provisions that already exist within the electricity rules.

The additional measures offered by privately owned electricity networks were announced by Energy Networks Australia in the Network Relief Package<sup>1</sup> and included (but were not limited to) the following relief measures:<sup>2</sup>

- Rebated network charges for small business customers experiencing financial stress and who are mothballing because of COVID-19.
- For small retailers, network charges will be rebated for residential customers that go into default because of COVID-19.
- For Large retailers, network charges will be deferred for residential customers who go on payment plans or hardship arrangements put in place as a result of COVID-19.

State governments and energy retailers have also provided support packages to electricity customers.

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<sup>1</sup> ENA, COVID-19 Electricity and Gas Network Relief Package, April 2020.

<sup>2</sup> These measures apply for the period 1 April to 30 June 2020. More information on the support and eligibility is provided at <https://www.energynetworks.com.au/about/our-members/covid-19-information/>

## Objective of the rule change proposal

The rule change proposed by the AER aims to regulate the support that network service providers (**NSPs**) provide to retailers by mandating that they must defer the recovery of network charges for electricity retailers incurred between 1 July 2020 and 31 December 2020 for six months. The rule would apply to retailers with customers who are in financial stress because of the COVID-19 pandemic and economic crisis.

A key objective of the proposed rule change is to support the financial resilience of the energy industry, by avoiding multiple retailer failures that might undermine the operation of the retail electricity market (despite the existence of the retailer of last resort (**ROLR**) scheme). Under this proposed rule, NSPs will be required to provide the designated financial support to the retailers. The AER posits that this would allow retailers to focus on the ongoing supply of energy and support for customers as they deal with the cash flow pressures arising because of the COVID-19 pandemic and economic crisis.

We agree with the policy objective of supporting Australian businesses that are in need as a direct result of COVID-19. The AER posits that if cascading retailer failure occurs it will have wide ranging effects on our customers and the economy. This assertion is not well supported with the information provided. Irrespective of this, we are deeply concerned that the assumed additional benefit of deferring the network component of a customer bill, over and above the support provided by governments to businesses and individuals and the ROLR scheme, do not outweigh the cost.

### **If a rule is made it must deliver better outcomes for customers**

In making a rule, the AEMC is obliged to ensure that it is consistent with the National Electricity Objective (**NEO**) and complies with the National Electricity Law (**NEL**). That is, the rule must not reduce the incentives for efficient investment, impose costs or risks that impact on the long term interests of consumers or impose costs on NSPs without a reasonable opportunity to recover those costs<sup>3</sup>. To ensure this mandate is met, we consider that any rule must:

- enable the costs incurred by NSPs in establishing and administering the scheme as well as providing the cash flow support to retailers to be recovered; and
- limit the cost of the scheme by ensuring only those retailers with a demonstrated need are eligible for the support and the support provided is contained to the demonstrated need.

The risk of retailer failure currently sits with retailers. This is appropriate because electricity retailers are rewarded for this risk through profit margins (which were amongst the highest in the world in NSW and Victoria in 2016-17)<sup>4</sup>. NSPs, on the other hand, are not rewarded for taking on financial risk or able to increase margins to cover this risk under the existing regulatory framework. The proposed rule transfers this risk<sup>5</sup> and imposes the costs of providing financial support to retailers on NSPs and, as a result, electricity customers. The scheme must therefore be no more costly than necessary and be the difference between failure and survival. It should only be accessed as a last resort mechanism and not simply top up reduced profit margins of retailers.

The remainder of this submission focusses on the design elements of the scheme to ensure that the scheme is appropriately targeted, and costs are minimised (see also Attachment 1).

### **Retailers must demonstrate the need for support and only access the support needed**

We support the inclusion of eligibility requirements and incentives that minimise the use of the scheme and reduce the costs to customers. The eligibility requirements should include the need to demonstrate

<sup>3</sup> The revenue and pricing principles under Section 24 of the NEL require that an NSP should be provided with a reasonable opportunity to recover at least the efficient cost of providing services and complying with a regulatory obligation.

<sup>4</sup> ACCC, Inquiry into the National Electricity Market, November 2019, p. 5.

<sup>5</sup> The AEMC has previously identified that a transfer of risk from one party to another party that is unable to manage the risk leads to inefficiencies and higher electricity costs (AEMC, Rule determination, Transmission loss factors, 27 February 2020, p. 92).

a gap between the cost of providing services to customers that do not pay bills because of COVID-19 and the revenue received from those customers. However, the retailer should also be required to:

- demonstrate that it exhausted the support available from state and federal governments;
- demonstrate that it has provided information to customers on the support available to them from the federal and state governments;
- agree to pay interest on the deferred charges equal to the higher of:
  - the rate of return nominated in the relevant price determination for the NSP; or
  - the cost to the NSP to access funds to cover the cash flow shortfall (recognising that there may be additional costs of accessing funds in current financial conditions);
- provide information on other options pursued by the retailer to obtain the support;
- provide a plan that demonstrates that the deferral of charges will enable it to remain financially viable over the 12-month period following the commencement of support; and
- agree to not increase prices to customers in subsequent years without demonstrating a corresponding increase in costs.

These requirements ensure that retailers only seek support (from NSPs and electricity customers) where:

- the support provided by government (from taxpayers) is insufficient to address the risk of failure resulting from the impact of COVID-19;
- the support under this scheme will be sufficient to achieve financial resilience; and
- the support is sought as a last resort.

In some circumstances the deferral of network charges (representing 43% of retailer costs according to the AEMC<sup>6</sup> and closer to 30% of the costs for SA Power Networks<sup>7</sup>) will be insufficient to save the retailer. In this case, electricity customers should not bear the cost and nor should the NSP (who will ultimately recover the costs from customers).

The proposed rule should specify principles and enable the AER to determine the information required to satisfy the eligibility requirements and whether, and to what extent, that information should be disclosed.

We do not support wide discretion of the AER to extend the scheme. It is important that this should be subject to a further rule change process, to provide appropriate transparency and consultation. However, given the uncertainty of the timing and impact of COVID-19, we consider it may be efficient to allow one extension of no more than 6 months with the AER required to consult on extension and provide reasons for the extension. Any discretion provided to the AER must be subject to an appropriate independent review mechanism.

Further, NSPs have matched the timeframe and scope of relief currently provided by electricity retailers.<sup>8</sup> Any mandated requirement on NSPs to provide retailers financial support must be matched by requirements on retailers, and be assured of flowing directly through to end-customers.

### **The financial impact on NSPs must not further dampen investment**

It is possible that mandating that NSPs support the electricity retail sector is likely to end up being a more costly exercise for everyday Australians than if the government were to provide the support directly. This is because it has the potential to increase the operational and financial challenges faced by NSPs.

NSPs are not immune from the impact of COVID-19 and the economic crisis. They are experiencing their own productivity and operational challenges of ensuring the workforce and community is safe whilst maintaining services. They are also supporting customers by waiving and deferring network charges to

<sup>6</sup> AEMC, Consultation Paper, National Electricity Amendment (Deferral of network charges) Rule 2020, 28 May 2020, p. 22.

<sup>7</sup> AER, Final Decision, SA Power Networks Distribution Determination 2020 to 2025, Overview, June 2020, p. 15.

<sup>8</sup> The AER's Statement of Expectations of energy businesses (SoE) outlines its expectation that energy retailers provide hardship relief for customers who may be in financial stress before 31 July 2020 and 'potentially beyond'.

residential and small business customers who are exhibiting hardship under the Network Relief Package. The revenue shortfall from the Network Relief Package, together with the expected reduction in revenue due to the impact of lower economic activity on electricity demand will have significant and ongoing cashflow implications on NSPs that may worsen before the economy recovers. This will be exacerbated by the proposed rule, and although NSPs will be able to recover these costs and deferred revenues in the following network tariff year, the impact on customer prices of the cumulative effect of revenue under recovery could be significant.

The reduced revenue expected for NSPs in 2020-2021 will occur at a time when the return contribution from net profit after tax (**NPAT**) in the post-tax revenue model (**PTRM**) for some NSPs will be negative as a result of the significant mismatch between the AER's forecast of inflation and expected inflation in the most recent determinations.<sup>9</sup> These same businesses will be required to provide financial support to retailers. We consider that it is reasonable to enable an NSP to seek an exemption from the scheme where the financial implications are severe.

Investment in networks is at an all-time low. The AER's proposed rule change has the potential to exacerbate financial impacts on NSPs, increase costs to customers and reduce the capital available for investment at a time when investment in networks can deliver the greatest benefits. Our businesses will play an important role in the economic recovery by investing in the network to maintain services and to expand the network to facilitate the transition to a lower cost, low emission future electricity system.

For example, under the Integrated System Plan (**ISP**) TransGrid will be responsible for investing more than \$5 billion in ISP Group 1 projects,<sup>10</sup> including the much needed transmission expansion project from NSW to South Australia that will shore up the security of electricity supply in the NEM, support new renewable generation and to crucially lower the costs of energy to customers. This investment will make a significant contribution to Australia's economic recovery post COVID-19. Requiring TransGrid to provide financial support to retailers will add to funding challenges at a critical time.

### **Who decides who pays?**

The role of the independent economic regulator has become blurred over the last few years and it is not unexpected that all agencies, including the AER, are considering options to support the economy and economic recovery. Nevertheless, we consider that supporting Australian businesses to survive the impacts of COVID-19 is a matter for government policy to be considered on an economy wide basis. This would ensure consistency, effectiveness, and the lowest cost means of achieving the policy objective. It is important to explicitly assess the costs and benefits of supporting a sector and who should pay for that support (i.e. customers or taxpayers).

I would be happy to discuss these matters further and can be contacted on 0421057821.

Yours sincerely,



**Sally McMahon**  
**Head of Economic Regulation and Energy Policy**  
**Spark Infrastructure**

<sup>9</sup> QTC, Issues raised by QTC at the AER Inflation Working Group meeting, 9 December 2019. Found at <https://www.aer.gov.au/system/files/QTC%20%E2%80%93%20Issues%20raised%20by%20QTC%20at%20the%20AER%20inflation%20working%20group%20meeting%20%E2%80%93%209%20December%202019.pdf>

<sup>10</sup> AEMO, Draft 2020 Integrated System Plan, December 2019.

# ATTACHMENT 1

## STAKEHOLDER FEEDBACK TEMPLATE

The template below has been developed to enable stakeholders to provide their feedback on the questions posed in this paper and any other issues that they would like to provide feedback on. The AEMC encourages stakeholders to use this template to assist it to consider the views expressed by stakeholders on each issue. Stakeholders should not feel obliged to answer each question, but rather address those issues of particular interest or concern. Further context for the questions can be found in the consultation paper. Stakeholders are also encouraged to provide evidence to support claims where possible.

### SUBMITTER DETAILS

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

### Question 1 – Impact of COVID-19 on retailers

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| <p>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 impact must be considered sufficient to lead to multiple retailer failures (i.e. not just one) if this rule is to be made.</p>  |
| <p>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>The Federal and state governments have a suite of support packages available to businesses and electricity consumers.</p> <p>ASX-listed retailers can readily access listed equity capital markets thereby also enabling efficient access to debt capital and bank markets. Non ASX-listed retailers should also be able to access sufficient equity capital and/or balance sheet support from parent entities/owners.</p> <p>Retailers may also have other options available to manage cash flow impacts and could enter voluntary arrangements with NSPs, generators and governments to be provided relief from wholesale costs, network charges and government levies.</p> |
| <p>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>The proposed rule will shift the cash flow impact from retailers to NSPs (ultimately paid for by customers) in the form of higher network charges and cost of capital.</p>  |

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

### Question 2 – Retailer eligibility

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| <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>A case by case consideration given appropriately narrow eligibility requirements would be more consistent with the objective. However, it would seem reasonable to assume that government owned retailers, and those identified under the retailer of last resort (ROLR) scheme should not require financial support.</p> <p>Consistency between eligibility between the Network Relief Package and this scheme will facilitate lower establishment and administration costs of the scheme. Further, the large retailers are likely to have sufficient reserves and balance sheet support that should be called upon and so they should be expressly excluded from the scheme under the proposed rule change.</p> |
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| <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>Eligibility requirements should include the need to demonstrate a gap between the cost of providing services to customers that do not pay bills because of COVID-19 and the revenue received from those customers: The retailer should <u>also</u> be required to:</p> <ul style="list-style-type: none"> <li>• demonstrate that it exhausted the support available from state and federal governments;</li> <li>• demonstrate that it has provided information to customers on the support available to them from the federal and state governments;</li> <li>• agree to pay interest on the deferred charges equal to the higher of the rate of return nominated in the relevant price determination for the NSP or the cost to the NSP to access funds to cover the cash flow shortfall (to recognise that there may be additional costs of accessing funds in current financial conditions);</li> <li>• provide information on other options pursued by the retailer to obtain the support;</li> <li>• provide a plan that demonstrates that the deferral of charges will enable it to remain financially viable over the 12-month period following the commencement of support; and</li> <li>• agree to not increase prices to customers in subsequent years without demonstrating a corresponding increase in costs.</li> </ul> <p>Any mandated requirement on NSPs to provide retailers financial support must be matched by requirements on retailers and be assured of flowing directly through to end-customers.</p> |
| <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>The rule could specify these principles and enable the AER to determine the information required to satisfy the eligibility requirements and whether, and to what extent, that information should be disclosed.</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>The deferral mechanism should include incentives that ensure the retailer only accesses support as a last resort. The incentives should include a requirement to provide information and have it disclosed as well as interest payment that is the higher of the rate of return nominated in the relevant price determination for the NSP or the cost to the NSP to access funds to cover the cash flow shortfall (to recognise that there may be additional costs of accessing funds in current financial conditions).</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>See comments above</p>   |

### Question 3 – Customer eligibility

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| <p>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?</p> | <p>Because the customer eligibility requirements are appropriately targeted and it aids simplicity, we support maintaining the same criteria as in the ENA’s Network Relief Package.</p> <p>Larger customers are more likely to benefit from other COVID-19 government support packages and are not excluded from commitments not to disconnect.</p> |
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## CHAPTER 4 – SECTION 4.2.2 – DEFERRAL TIMEFRAME AND TERMS

### Question 4 – Length of deferral period

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| <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>The deferral period should reflect the needs of the retailer up to 6 months.</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>NSPs will incur direct costs of funding the cash flow shortfalls during the period of deferral. A longer deferral period will increase these costs.</p> <p>A longer deferral period will increase the revenue to be recovered from all other customers in the next tariff year. Therefore, the period should be no longer than the support needed by the retailer or 6 months to limit the impact on customer prices in the following year.</p> <p>A longer deferral period will place more strain on the NSPs credit rating, which would be expected to drive up costs of borrowing, and which is ultimately passed onto customers.</p> |



### 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?

The AER should only have discretion to extend the scheme by 6 months. Any further extension should be subject to a further rule change process. The AER should be required to consult on extension and provide reasons for the extension. Any further discretion provided to the AER must be accompanied by an appropriate independent review mechanism.

## CHAPTER 4 – SECTION 4.2.3 – DEFERRAL OF PAYMENTS BETWEEN DNSPS AND 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?

Applying the scheme to a broader set of NSPs will reduce the burden of the scheme on any individual NSP but may increase the administration costs. Generally, the cost of transmission in a customer’s bill is immaterial, e.g. less than 5% in NSW. Given the level of transmission capital expenditure being required from TNSPs under AEMO’s ISP, and the competing requirement for cash to support retailers versus cash required to drive investment and the economic recovery post COVID-19, payment of transmission charges to the TNSP should not be deferred. However, NSPs should also be allowed to be excluded from the scheme where the financial burden is significant. Given the relative contribution to a customer bill, other components of the bill, such as generation and government charges, could also be considered for deferral.

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?

Payment of transmission charges to TNSPs should not be deferred. This will reduce the cost and impact of the scheme.

## CHAPTER 4 – SECTION 4.3 – PRACTICAL IMPLEMENTATION OF PAYMENT DEFERRALS

### Question 7 – Process for deferring payment of network charges

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| <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>For the NSPs to determine.</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, this would be simpler.</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>By agreement between the NSP and retailer and oversight by the AER.</p> |

## CHAPTER 4 – SECTION 4.4 – IMPACT ON NSPS

### Question 8 – Impact of proposed deferral mechanism on NSPs

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| <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>NSPs must be able to recover the cost of the scheme and addressing the cash flow impacts. This will ensure the rule complies with the law, does not increase risk or dampen investment or have a detrimental effect on longer term price, reliability and security of supply.</p> <p>The interest charged to retailers accessing the support should be sufficient to cover:</p> <ul style="list-style-type: none"> <li>• The estimated cost of administering the scheme</li> <li>• The regulated return on the funds sought by the NSP to cover the cash flow impact</li> <li>• Additional costs that might be incurred because of unusual capital market conditions.</li> </ul> |
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|  | <p>We do not consider the cost pass through mechanism is appropriate or effective to recover these costs because the process for recovery is delayed and subject to a threshold.</p> <p>NSPs are not immune from the impact of COVID-19 and the economic crisis. They are experiencing productivity and operational challenges of ensuring the workforce and community is safe whilst maintaining services.</p> <p>The shortfall in revenue under the Network Relief Package, together with the significant reduction revenue due to the impact of lower economic activity on electricity demand will have significant and ongoing cashflow implications that may worsen before the economy recovers.</p> <p>The reduced revenue expected for NSPs in 2020-2021 will occur at a time when the return contribution from net profit after tax (NPAT) in the post-tax revenue model (PTRM) could be negative as a result of the significant mismatch between the AER's forecast of inflation and expected inflation in the most recent determinations.<sup>11</sup> These same businesses will be required to provide financial support to retailers.</p> <p>An NSP should be able to seek an exemption from the scheme where the financial implications are severe.</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>DNSP's must be able to recover deferred revenue in following years to reduce the financial impact and avoid shifting costs on to future customers.</p> <p>Prices in the following network tariff year will be higher due to the recovery of costs associated with the scheme and deferred revenue. The cumulative effect with under recovered revenue from lower demand and the Network Relief Package could be significant.</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>DNSP's must be able to recover the direct costs of supporting retailers. The cost should include the cost of the scheme and the higher of the relevant WACC or the cost of accessing funds in current market conditions which could be more costly.</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>NSPs must be provided with a reasonable opportunity to recover the efficient cost.</p> <p>There is an increased risk to NSPs where repeated government and regulatory intervention requires NSPs to underwrite policy objectives.</p>  |

<sup>11</sup> QTC, Issues raised by QTC at the AER Inflation Working Group meeting, 9 December 2019. Found at <https://www.aer.gov.au/system/files/QTC%20%E2%80%93%20Issues%20raised%20by%20QTC%20at%20the%20AER%20inflation%20working%20group%20meeting%20%E2%80%93%209%20December%202019.pdf>