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25 June 2020

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted electronically

Dear Mr Pierce,

Re: Deferral of payment of network charges - ERC0302

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to make this submission to the Australian Energy Market Commission's (the Commission's) consultation on a rule change proposal to allow retailers to defer the payment of network charges.

Stakeholders are focused on the impact that COVID-19 is having on the economy and in particular, challenges faced by energy consumers. This in turn creates financial challenges for energy retailers. However, the extent of this impact differs depending on a retailers' size, composition of its customer base (particularly whether it is supplying business customers that are deeply affected by COVID-19), and established financing arrangements. At this stage, the likely peak and duration of the impact also remains highly uncertain.

We appreciate the Australian Energy Regulator (AER) and Commission's efforts to try to maintain retailer viability during this uncertain environment. We also note that the AER released an important customer-facing response to COVID-19, being the Statement of Expectations, which placed a number of parameters on retail and network businesses' operations during the pandemic. While this ensures that consumers remain connected to their energy supply, it has the unintended consequence of limiting retailers' ability to manage risks and cash flow.

The Commission must therefore consider the rule change proposal in light of the Statement of Expectations. In particular as the rule change proposal, while well intentioned, has the potential to increase bills. At the same time, the deferral of network payments should not function as a sustained alternative form of retailer finance.

Problems with the deferral of network payments

The AER's proposal is clear that deferral is a temporary measure to assist those retailers experiencing cash flow problems as a result of COVID-19 and the Statement of Expectations. It is intended that during the second half of 2020, network charges can be deferred and recovered

in 2021. This is a worthy objective and we support efforts to provide support to all retailers that are experiencing cash flow issues, particularly as many forms of government and other assistance will be withdrawn or scaled back in the second half of 2020.

The package, however, may exacerbate some challenges for consumers and for retailers. For example, the deferral of network costs until 2021 will increase retailers' interest costs which will ultimately be borne by consumers. This could coincide with other adjustments that retailers will need to make in the wake of the pandemic. Examples might be the recovery of suspended and deferred bills (due to short term payment assistance), and adjustment to bills where networks have provided estimated rather than actual meter reads. Retailers will face many challenges in managing their customers and their own businesses over the next 12 months.

This contrasts with networks' ability to manage short term cash flow issues. As monopoly businesses that operate under revenue caps, networks would most likely be able to recover any borrowing costs they incur due to the deferral of payment and at an interest rate lower than retailers could obtain.

A further issue for the Commission's careful consideration is the incentive that any deferral could create for retailers to avoid more fundamental changes to their business model to maintain their financial viability and to limit their exposure to future economic downturns. Retailers must act in an economically rational manner, and should seek additional finance from a bank, equity from shareholders or renegotiate contracts with counterparties (such as generators and large customers). There is a real potential for moral hazard, particularly if the AER is also able to extend the deferral in the way it proposes. The package should provide a short term solution to a very specific problem.

Structure of deferral package

The consultation paper discusses a number of ways to structure the deferral package, including limiting its scope of the basis of size, ownership, type of customers who are receiving support from their retailer, and duration. In light of our concerns, Red and Lumo recommend that if the Commission proceeds with the rule change, the deferral should be available to **all** retailers strictly on an opt in basis, albeit with some conditions. This would limit its scope and minimise some of the more potentially harmful effects.

We also strongly oppose any amendments to the National Electricity Rules that create a distinction between different retailers - such as eligibility criteria on the basis of current size or ownership structure, for example. This would be a dangerous precedent in a competitive market and undermines the National Electricity Objective as it is not efficient nor in the long term interests of consumers. Additionally, it contradicts competitive neutrality, the foundation for full retail competition as a result of the Hilmer Review.

The consultation paper refers to some ambiguity about the scope of the scheme as proposed by the AER and invites views on whether it should also apply to large consumers on deferred

payment arrangements. In our view, the scheme should only allow network cost deferral for customers on payment plans, in hardship management or suspension of debt for residential and small businesses consumers. The Commission should also note, however, that while this sounds reasonable, without any consequences of non-payment it can be difficult to engage with these customers to establish these arrangements.

We share the Commission's view that retailers are better able to manage risks in the case of large consumers who are struggling to pay for their energy on time and they should be strongly encouraged to do so.¹

The consultation paper also discusses how to create appropriate incentives for retailers to defer network costs. It refers to the New Zealand Electricity Authority's amendment to the *Electricity Industry Participation Code 2010* to assist retailers. We consider that the New Zealand scheme avoids the problems identified above, as it places important parameters for retailer access. In particular, the retailer must prove that it:

- was financially sound prior to COVID-19; and
- has been materially impacted by additional doubtful debt as a result of the impact of the COVID-19 lockdown in New Zealand; and
- cannot cover this impact through other facilities or access support from shareholders.²

We would support adopting the approach taken by the New Zealand Authority. It would also align with the AER's existing provisions under s130 of the National Energy Retail Law that allows it to seek information from retailers that it has reason to believe may be vulnerable to failure. The AER could, for example, expect to see financial disclosures made by any publicly listed company wishing to access the scheme.

We view this as a better model than allowing a network to charge interest on the outstanding payment, which could either create a windfall gain for the network or not reflect the true cost of finance for a retailer, which would be set by a bank, or other sources of finance (such as equity). Moreover, it may not reflect the networks' own borrowing costs. These are substantially lower than those of retailers due to the regulated monopolistic nature of their assets. Allowing a retailer to obtain finance at this artificially low rate can distort a retailers' decision about whether to access relief through a network deferral or through traditional sources.

Retailer of Last Resort Arrangements

The National Energy Retail Law provides consumers protection from being disconnected should their retailer fail, this is known as the Retailer of Last Resort (RoLR) arrangements. The RoLR arrangements in the electricity market have only been used twice since their creation, where customers of a failed retailer revert to the standing offer of their incumbent retailer. Alongside

¹ Australian Energy Market Commission (2020), *Consultation Paper - Deferral of Network Charges*, pp. 14-15

² Ibid., pp. 13

these events, the Commission completed a review on NEM financial market resilience in 2015. This review focused on the failure of a *large* participant in the NEM with a significant retail customer base and identified that it could have significant flow-on effects to other participants. Further, the Commission found that this could threaten the financial stability of the NEM, result in disruptions to consumers, and affect public confidence. In light of this report, we consider that it is prudent that when designing the final rule the Commission allow any retailer that is experiencing cash flow issues as a result of COVID-19 to access emergency support but also retain the incentive to address more fundamental challenges to their current business model.

As a further point about the current RoLR framework, the AER in their rule change proposal also notes that a RoLR event is likely to have “consequences for customers, including reduced options and poor price/service outcomes, could worsen the financial effects of the COVID-19 pandemic”.³ Historically, there were some concerns that RoLR customers would transition to an uncompetitive standing offer but this is now addressed through the Default Market Offer (DMO). As the AER Chair has stated “the DMO is not meant to give these customers the best possible energy price. It simply means their energy provider can’t charge them an unjustifiably high price”⁴. On this basis, we do not agree with the likely impact on customers should a retailer failure occur.

Duration of assistance

The rule change proposal allows the AER to make an administrative decision to have flexibility to extend the rule past its initial time frame. Given our concerns about the potential unintended consequences of allowing retailers to defer network payments, we consider limiting the available time frame to 31 December 2020. It should be made clear to all retailers who choose to access the deferral of network costs that it is an emergency measure that reflects the short term challenges of COVID-19. We do not consider that the AER should be able to extend the deferral without proposing another rule change.

Any extension must be re-tested against the National Electricity Objective to avoid potential issues for consumers, retailers and networks. The Commission notes the problems for some market participants that uncertainty about the duration of the scheme would create.⁵ As such, any proposal to extend the scheme should involve a review of its impact (past and future) through stakeholder consultation under a rule change process, rather than as an administrative decision by the AER. Furthermore, any retailer who is expecting to continue to experience cash flow challenges into 2021 should be encouraged to seek a more sustainable solution.

³ Australian Energy Regulator (2020), Rule Change Proposal - Extension Of Time For Retailers To Pay Network Charges For Eligible Customers, pp. 4.

⁴ Clare Savage, Australian Energy Regulator, 30 April 2020, Media release: Default Market Offer continues to protect disengaged energy customers, Available online: <https://www.aer.gov.au/news-release/default-market-offer-continues-to-protect-disengaged-energy-customers>

⁵ Ibid, pp.16



Implementation

The Commission has released a consultation paper and is expected to publish a final decision and rule on 23 July. We recommend that should the Commission decide to proceed with the rule, it allow a brief consultation on the proposed rules. This could be limited to affected stakeholders.

About Red and Lumo

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in South Australia, Victoria, New South Wales, Queensland and the ACT to over 1 million customers.

Red and Lumo thank the Commission for the opportunity to comment on the consultation paper. Should you wish to discuss or have any further enquiries regarding this submission, please call Geoff Hargreaves, Regulatory Manager on 0438 671 750.

Yours sincerely

A handwritten signature in black ink, appearing to be "Ramy Soussou", with a stylized, circular flourish at the end.

Ramy Soussou

General Manager, Regulatory Affairs & Stakeholder Relations

Red Energy Pty Ltd

Lumo Energy (Australia) Pty Ltd