

Determination

Unpaid distribution charges pass-through for 2017-18 regulatory year

Jemena Gas Networks

 September 2016

© Commonwealth of Australia 2016

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

* the Commonwealth Coat of Arms
* the ACCC and AER logos
* any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the
Director, Corporate Communications,
Australian Competition and Consumer Commission,
GPO Box 4141,
Canberra ACT 2601
or publishing.unit@accc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au
AER Reference: 60652

Contents

[Overview 1](#_Toc460416198)

[1 Determination 3](#_Toc460416199)

[2 Jemena Gas Networks' application 4](#_Toc460416200)

[2.1 Background 4](#_Toc460416201)

[2.2 Calculation of the pass–through amount 4](#_Toc460416202)

[3 AER Assessment 6](#_Toc460416203)

[3.1 Relevant dates 6](#_Toc460416204)

[3.2 Jemena Gas Networks' application under clause 531 6](#_Toc460416205)

[3.2.1 Retailer insolvency event 7](#_Toc460416206)

[3.2.2 Unpaid distribution service charges 7](#_Toc460416207)

[3.2.3 Jemena Gas Networks' ability to seek recourse to credit support 9](#_Toc460416208)

[3.2.4 Amount recoverable from Go Energy's administrators 10](#_Toc460416209)

[3.3 Calculation of the pass–through amount 10](#_Toc460416210)

[3.4 Other considerations 10](#_Toc460416211)

# Overview

We regulate Jemena Gas Networks distribution businesses in New South Wales. We do so under the National Gas Law (NGL) and the National Gas Rules (NGR). Jemena Gas Networks is the largest gas distribution network operator in NSW.

Pass–through events are contemplated in access arrangements. The pass–through mechanism recognises that a service provider can be exposed to risks beyond its control. A cost pass–through enables a service provider to recover (or pass–through) the costs that are not built into its access arrangement. Not all cost pass–throughs lead to higher prices for customers. Sometimes actual costs incurred are lower than allowances or forecasts, meaning revenues must be returned to customers in a subsequent regulatory year.

The NGR includes a prescribed pass–through should a retailer insolvency event occur.[[1]](#footnote-2) A retailer insolvency event occurs when a retailer fails, during an access arrangement period, to pay a service provider an amount to which the service provider is entitled for the provision of reference services, if:[[2]](#footnote-3)

* an insolvency official has been appointed in respect of that retailer; and
* the service provider is not entitled to payment of those charges in full under the terms of any credit support provided in respect of that retailer.

On 8 August 2016 Jemena Gas Networks submitted an application to the AER for a pass–through of costs related to unpaid distribution charges due to retailer Go Energy entering administration and thus becoming a retailer insolvency event. Its application submits that the amount it will pass–through to gas users, to be recovered through distribution prices in 2017–18, is $117,536.[[3]](#footnote-4)

Jemena agreed to remove confidentiality from the pass–through amount and Go Energy's distribution service charge liability.[[4]](#footnote-5) Therefore, this determination includes the relevant amounts.

The AER must make a determination on Jemena Gas Networks' pass–through application.[[5]](#footnote-6) We must consider, with reference to the factors specified in the rules, whether the pass–through is justified and whether the relevant amounts have been correctly calculated.

We have assessed Jemena Gas Networks' application under the framework provided by the rules. In particular, we have considered:

* the provisions of the NGR and NGL specifically cl. 502, 516-519, cl.522 , cl.528 and cl.531 of the NGR
* the material provided in Jemena Gas Networks application[[6]](#footnote-7)
* the Jemena Gas Networks Access Arrangement and the Jemena Gas Networks undertaking.

We determined that Jemena Gas Networks has correctly identified the pass–through amount. Jemena Gas Networks can seek an adjustment of its maximum allowed revenue in 2017–18 by this amount. We will engage further with Jemena Gas Networks about how this will occur in accordance with the procedures set out in Jemena Gas Networks' access arrangement. This may mean that these costs will not actually be recovered until sometime after 2017–18.

# Determination

We are satisfied that Jemena Gas Networks has established that a retailer insolvency event has occurred and that the amounts Jemena Gas Networks submitted are for the provision of reference services.

The rules require us to determine the amount that should be passed through to customers. We based our decision on an assessment of the factors set out in clause 531 of the rules.

We consider that Jemena Gas Networks has correctly identified the pass–through amount. In our view Jemena Gas Networks has not taken (or omitted) any action that would be likely to increase (or decrease) the magnitude of the positive change event. That is, Jemena Gas Networks has been unable to take any other mitigating measures that would reduce the severity of the costs imposed on it, or the revenues foregone, due to Go Energy's insolvency.

This pass–through amount is $117,536 (in 2016–17 dollars). To pass–through this amount in the 2017-18 regulatory year, Jemena Gas Networks can seek an adjustment of its maximum allowed revenue for 2017–18. We will engage further with Jemena Gas Networks about how this will occur in accordance with the procedures set out in Jemena Gas Networks' access arrangement.

We consider that unpaid distribution charges are costs that can be recovered by a service provider as part of a retailer insolvency event.

# Jemena Gas Networks' application

Jemena Gas Networks' application was submitted on 8 August 2016. The application and its attachments are available on our website.[[7]](#footnote-8)

## Background

Jemena Gas Networks' application relates to a retailer insolvency event triggered for Go Energy Pty Ltd (Go Energy).

Go Energy was an electricity and gas retailer with a licence to operate in the National Electricity Market (NEM) and the gas Short Term Trading Market (STTM).

Go Energy was late paying its December 2015 and January 2016 invoices and did not paid its overdue March 2016 and April 2016 invoices issued by Jemena Gas Networks.

This led to Jemena Gas Networks not being paid for distribution services it provided to Go Energy. These unpaid distribution charges amounted to $117,536.

Jemena Gas Networks is seeking a pass–through of $117,536 equivalent to the unpaid distribution charges of Go Energy escalated by the time value of money.

A retailer insolvency event is defined under clause 531 of the National Gas Rules. Clause 531 allows Jemena Gas Networks to recover the increase in costs of providing reference services in the event of retailer insolvency.

A retailer insolvency event is the failure of a retailer during an access arrangement period, to pay a distributor an amount to which the service provider is entitled for the provision of reference services, if: (a) an insolvency official has been appointed in respect of that retailer; and (b) the distributor is not entitled to payment of those charges in full under the terms of any credit support provided in respect of that retailer.[[8]](#footnote-9) The rules do not set a materiality threshold for considering a retailer insolvency event.

## Calculation of the pass–through amount

Jemena Gas Networks provided the invoices for the March 2016 and April 2016 period. The April 2016 invoice covered the period 1 April to 4 April 2016.[[9]](#footnote-10)

Jemena Gas Networks seeks to recover the pass–through amount in the 2017–18 financial year as part of adjustment to tariffs permitted by its undertaking.

Since Jemena Gas Networks will not be able to obtain any recovery of unpaid distribution charges until 2017-18, these costs need to be escalated by the appropriate cost of capital. The cost of capital as set out in our Jemena Gas Networks access arrangement determination is 5.41 per cent per annum. This rate has not been updated as it is currently the subject of an appeal to the Federal Court.

Jemena Gas Networks submitted that the approved pass–through amount will be adjusted in accordance with the tariff variation mechanism in its access arrangement. We will engage further with Jemena Gas Networks about how this will occur in accordance with the procedures set out in JGN's access arrangement.

# AER Assessment

## Relevant dates

The rules provide that, an application to us under clause 531 must be made within 90 business days of the relevant event occurring.[[10]](#footnote-11)

Jemena Gas Networks has submitted that in order to determine whether a retailer insolvency event has occurred, and the quantum of unpaid charges that service provider should receive as a consequence, the following needs to have occurred:

* an insolvency official has been appointed in respect of that retailer, and
* the service provider is not entitled to payment of those charges in full under the terms of any credit support provided in respect of that retailer.[[11]](#footnote-12)

Jemena Gas Networks made its pass–through application on 8 August 2016, which is within the set timeframe. Our assessment is based on the following points:

* a retailer insolvency event has occurred
* determination of relevant costs
* Jemena Gas Networks ability to seek recourse for payment of charges via credit support, and
* amount(s) that Jemena Gas Networks is or will be entitled to recover from Go Energy's administrator.

The retailer insolvency event occurred with the appointment of an external administrator to Go Energy on 1 April 2016.[[12]](#footnote-13)

## Jemena Gas Networks' application under clause 531

In order to approve an amount of money to be passed through to energy consumers, the AER must determine an insolvency pass–through amount in accordance with clause 531(3) of the National Gas Rules.

… insolvency pass through amount that reflects the increase in the costs of providing reference services that the distributor has incurred and is likely to incur until the end of the applicable access arrangement period solely as a consequence of the retailer insolvency event, but does not include:

i. any amount recovered or recoverable from a retailer or a guarantor of a retailer under this Part; or

ii. any costs that are recoverable under a RoLR cost recovery scheme distributor payment determination.

### Retailer insolvency event

Further to this, clause 531(4) of the National Gas Rules provides that retailer insolvency event is defined as follows:[[13]](#footnote-14)

…**retailer insolvency event** means the failure of a retailer during an access arrangement period, to pay a distributor an amount to which the service provider is entitled for the provision of reference services, if:

a) an insolvency official has been appointed in respect of that retailer; and

b) the distributor is not entitled to payment of those charges in full under the terms of any credit support provided in respect of that retailer.

The definition of a retailer insolvency event in clause 531(4) above outlines the requirements for a retailer insolvency event to be considered as having occurred. We consider a retailer insolvency event has occurred because:

* Go Energy Pty Ltd appointed an external administrator
* No credit support was provided by Go Energy and Jemena Gas Networks has no recourse to seek payment of charges via credit support. Our consideration of Jemena Gas Networks ability to seek recourse to credit support is discussed in section 3.2.3.

Jemena Gas Networks provided regarding the appointment of an administrator to Go Energy and Go Energy's outstanding invoices.[[14]](#footnote-15) We have also accessed information regarding the AER's revocation of Go Energy's retailer authorisation.[[15]](#footnote-16)

Taken together, these facts point to a retailer insolvency event has occurred.

### Unpaid distribution service charges

We consider Jemena Gas Networks can recover its unpaid distribution charges under clause 531 of the National Gas Rules.

Clause 531(3) provides that '…the AER must determine a retailer insolvency pass through amount that reflects the increase in costs of providing reference service…' The meaning of the phrase “increase in costs” in the context of clause 531(3) is somewhat unclear.

This phrase could refer to any additional administrative costs incurred by the service provider solely as a consequence of the insolvency, including the costs of recovering unpaid revenue through the insolvency process. However, the administrative costs associated with managing the impact of the insolvency are likely to be small, and some of these costs would be costs that Jemena Gas Networks would ordinarily have borne in its dealings with retailers in any event. The bulk of the actual loss caused to Jemena Gas Networks following the insolvency event is in the form of unpaid distribution charges. Thus, if clause 531 is interpreted as applying to administrative costs only, it is likely to be deprived of any meaningful or material purpose.

In this context we consider it is also appropriate to consider relevant accounting principles in identifying what is properly considered to be a cost. The Australian Accounting Standards Board in its Framework document (for preparation of financial statements) defined expenses (that is, costs) as decreases in economic benefits in the form of outflows or depletions of assets. The Australian Accounting Standards Board further stated losses represent decreases in economic benefits and as such they are no different in nature from other expenses.[[16]](#footnote-17) Given that Jemena Gas Networks had actually provided the relevant services to Go Energy (as it was required to do), it was appropriate for Jemena Gas Networks to recognise that revenue on an accruals basis, and it is therefore appropriate to account for the loss of that revenue (as result of Go Energy's insolvency) as a cost.

There are also other indications in Part 21 of the National Gas Rules that clause 531 is intended to have a broader effect, and (specifically) is intended to allow recovery of foregone revenue in the form of unpaid distribution charges in the specific circumstances of a retailer insolvency event.

* Clause 531(2)(c) requires the service provider to provide evidence of 'the amount to which the service provider is entitled to under any relevant credit support…', ‘the maximum amount of any credit support that the distributor was entitled to request’, and ‘any amount that the distributor is likely to receive as a result of the winding up of the retailer’. These references, and the fact that clause 531 appears in the National Gas Rules immediately after the provisions that deal with credit support, indicate that the purpose of clause 531 is to limit recover under clause 531 to amounts, including unpaid revenue, that are not able to be recovered via other means (including up to the maximum amount of credit support that the service provider was entitled to receive).
* Given the likely small size of any increases in administrative costs as a result of the insolvency event, it seems that the requirement on the service provider to provide evidence of these matters would not serve much, if any, practical purpose if those administrative costs were the only costs that are recoverable under clause 531.
* It is also worth noting that clause 531 does not require the service provider to provide evidence of administrative costs, but only of whether it is entitled to recover any amount by other means. This suggests that administrative costs are not the only costs that are recoverable under clause 531.
* The heading of clause 531 explicitly refers to a 'pass through of unpaid distribution service charges'. This suggests that the intent of the rule is to allow service providers to recover unpaid distribution services in the circumstances of a retailer insolvency event. Under clause 502, 'distribution service charges' specifically include “charges for distribution pipeline services and charges for customer connection services.”

In relation to the policy objective of clause 531, it is also worth noting that under the National Gas Rules Jemena Gas Networks is required to provide reference services to a retailer in order to promote retail competition. Jemena Gas Networks therefore had no choice but to contract with Go Energy and therefore otherwise be put at risk of an insolvency event occurring.

### Jemena Gas Networks' ability to seek recourse to credit support

We are satisfied that no credit support was available to Jemena Gas Networks at the time of the retailer insolvency event. Further, we consider Jemena Gas Networks undertook appropriate action within a reasonable period to obtain credit support once Go Energy triggered an instance where no credit allowance was to be extended under clause 522 of the National Gas Rules.

Jemena Gas Networks submitted that while Go Energy was paying its bills, Jemena Gas Networks was not entitled to ask Go Energy for credit support under the National Gas Rules.[[17]](#footnote-18) This is because the National Gas Rules provided Go Energy a credit allowance of $84,403,272, which exceeded Go Energy's distribution service charge liability, which was no greater than $145,649.[[18]](#footnote-19) Where the credit allowance exceeds the distribution service charge liability, a service provider is not entitled to seek credit support.

When Go Energy failed to pay two consecutive invoices (March and April 2016), Jemena Gas Networks exercised its right under clause 522 to seek credit support from Go Energy of $145,649 prior to Go Energy being put into administration. Jemena Gas Networks provided supporting documentation of its request on the 2 March 2016 to Go Energy for credit support.[[19]](#footnote-20) However the requested credit support was never provided.

Jemena Gas Networks further submitted it did not terminate the Reference Service Agreement with Go Energy and, under the circumstances, did not consider it would have been appropriate to terminate at that time because:[[20]](#footnote-21)

* Go Energy had paid the outstanding invoices for December 2015 and January 2016, did not default on its February 2016 invoice and had not yet received or defaulted on its March 2016 invoice (i.e. no monies were currently outstanding)
* terminating the Reference Service Agreement remains a last resort action as this could only be enacted by physically disconnecting end use customers.

We are satisfied Jemena Gas Networks actions with regards to Go Energy were reasonable, We consider that Jemena Gas Networks has behaved prudently in its decisions and actions relating to the risk of the positive change event occurring. In our view Jemena Gas Networks has not taken (or omitted) any action that would be likely to increase (or decrease) the magnitude of the positive change event.

### Amount recoverable from Go Energy's administrators

Jemena Gas Networks submitted it is currently unclear whether Jemena Gas Networks will recover any funds from the Go Energy administrators. Jemena Gas Networks stated it has completed all available processes at this point in time to recover funds from Go Energy, including lodging proof of debt with administrators.

We are satisfied that Jemena Gas Networks is currently unable to recover any funds from Go Energy administrators. Jemena Gas Networks advised that if it did receive funds from the administrator, it would submit a negative pass–through to return that money to customers. [[21]](#footnote-22) That is, it would effectively subtract that amount from any positive pass–through amount granted by the AER in relation to the Go Energy insolvency. We will be following up the issue of recovery of funds once Go Energy's administrator has completed its assessment.[[22]](#footnote-23)

## Calculation of the pass–through amount

The details of the calculation are provided in section 2.2 above.

We consider that $117,536 of the pass–through amount should be passed through to consumers. Given the relatively small value of the pass–through amount, we consider it should be recovered only in a single year, rather than across regulatory control years.

## Other considerations

In making a decision on how much of the cost pass–through event should be passed through, we have also taken into account:[[23]](#footnote-24)

* the time cost of money
* the need to ensure that the service provider only recovers any actual or likely increment in costs to the extent that such increment is solely as a consequence of a cost pass–through event
* the efficiency of the service provider's decisions and actions in relation to the risk of the cost pass–through event, including whether the provider has failed to take any action that could reasonably be taken in respect of the event and whether the service provider has taken or omitted to take any action where such action or omission has increased the magnitude of the amount in respect of the event
* whether the costs of the cost pass–through event have already been factored into the calculation of the service provider’s annual revenue requirement
* and other factors the AER considers relevant and consistent with the National Gas Law and National Gas Rules.

These factors are considered in turn below.

* We consider that it is appropriate to account for the time cost of money in this decision, as the costs are passed through to users in the next regulatory year to which those costs occurred.
* We consider that the costs to be recovered by Jemena Gas Networks due to this pass–through are solely attributable to the retailer insolvency event.
* We consider that the costs of the pass–through event are established by clause 531 and are defined as the failure of a retailer during an access arrangement period, to pay a service provider an amount to which the service provider is entitled for the provision of reference services.
	+ As such, the costs of the pass–through event are, by definition, not factored into Jemena Gas Networks' maximum allowed revenue for the 2015-2020 regulatory control period.
* We consider that the amounts incurred relating to the retailer insolvency event pass–through under consideration is not the subject of any previous determination by us.
* We do not consider any other matters to be relevant.
1. NGR, Cl. 531 [↑](#footnote-ref-2)
2. NGR, Cl. 531(4) [↑](#footnote-ref-3)
3. JGN, Pass through of unpaid distribution service charges, 8 August 2016 [↑](#footnote-ref-4)
4. JGN to AER, Re: Checking JGN's claim for confidentiality, 6 September 2016 [↑](#footnote-ref-5)
5. NGR, Cl. 531(3) [↑](#footnote-ref-6)
6. JGN, Pass-through of unpaid distribution service charges, 8 August 2016 [↑](#footnote-ref-7)
7. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/cost-pass-throughs/jemena-gas-networks-cost-pass-through-application-unpaid-distribution-charges> [↑](#footnote-ref-8)
8. NGR, Cl. 531(4) [↑](#footnote-ref-9)
9. JGN, Response to AER information request (2), 15 August 2016. [↑](#footnote-ref-10)
10. NGR, Cl. 531(2) [↑](#footnote-ref-11)
11. NGR, Cl. 531(4) [↑](#footnote-ref-12)
12. NGR Cl. 531(4) [↑](#footnote-ref-13)
13. NGR, Cl. 531(4) [↑](#footnote-ref-14)
14. JGN, Pass-through of unpaid distribution service charges, 8 August 2016 [↑](#footnote-ref-15)
15. <https://www.aer.gov.au/retail-markets/retailer-failure>; <https://www.aer.gov.au/retail-markets/retailer-failure/information-for-go-energy-customers> [↑](#footnote-ref-16)
16. Australian Accounting Standards Board, Framework for the Preparation and Presentation of Financial Statements 2016, p.18 [↑](#footnote-ref-17)
17. NGR, Cl. 522 [↑](#footnote-ref-18)
18. NGR, Cl. 518-519 [↑](#footnote-ref-19)
19. JGN, Pass-through of unpaid distribution service charges, 8 August 2016 [↑](#footnote-ref-20)
20. JGN, Response to AER information request (1), 12 August 2016 [↑](#footnote-ref-21)
21. JGN, Pass-through of unpaid distribution service charges, 8 August 2016 [↑](#footnote-ref-22)
22. NGR, Cl. 531(2)(c)(iv) [↑](#footnote-ref-23)
23. AER, Draft decision Jemena Gas Networks Access Arrangement 2015-2020, Attachment 11 - Reference tariff variation mechanism, November 2014, section 11.3.1. [↑](#footnote-ref-24)