AUSTRALIAN
ENERGY
COUNCIL

Essential Services Commission
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Next Steps for the Victorian Default Offer

The Australian Energy Council (the '***AEC'***) welcomes the opportunity to make a submission to the Essential Services Commission (the '***ESC'***) on its *Next Steps for the Victorian Default Offer (VDO)* (the '**C*onsultation Paper'***).

The AEC is the industry body representing 21 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 2022 VDO is the fourth iteration of the regulated price since it was introduced in 2019. Since the initial year, there have been minor amendments to the ESC's methodology, but largely, these have not fundamentally changed the impact of the VDO on electricity retailers and competition. The AEC considers that in its three years of operation, the VDO has dampened price signals in the market, and limited incentives for consumers to shop around and seek out the cheapest energy deals.

While the structural issues with the ESC's approach to regulating the VDO that the AEC has raised in previous submissions remain, this submission focuses on issues particularly pertinent to the 2022 VDO calculation. These issues relate primarily to the costs of bad debt resulting from the COVID pandemic, the risk profile faced by retailers in 2022, the length of the regulatory period, and the approach to calculating the wholesale costs in a half year VDO.

Bad debt costs and retailer risk

In its 2021 VDO determination, the ESC applied a $6 per customer bad debt allowance to enable retailers to recover a proportion of what was expected to be significantly higher bad debt costs resulting from the COVID pandemic. This allowance was welcomed by the AEC, and an acknowledgement that 2020 was an unusual year, where retailers were significantly encumbered by emergency interventions designed to protect customers during the pandemic.

In the Consultation Paper, the ESC flags the potential to remove this allowance in 2022, noting that there are "some indications that retailers' financial provisions for bad debts in 2022 will be lower than they were for 2021".[1]

The AEC disagrees with this characterisation, and does not consider the publicly available evidence as to the state of debt across the industry is reflective of a reduced bad debt risk in 2022. AGL, who the ESC note has

[1] Page 15 of Consultation Paper

reduced its bad debt provision by $5M, retains a very high bad debt provision when compared to years prior to the pandemic. AGL's half yearly results presentation referred to in the Consultation Paper notes that its expected credit losses remain markedly higher than in previous years, despite the $5M reduction in the bad debt provision. The other publicly listed retailer, Origin, is noted by the ESC as having not changed its provision at all.

The ESC's datasets similarly illustrate a concerning picture for retailer debt. For customers who can pay their ongoing usage, average debts have risen by 21% since 2019. For customers who cannot pay their ongoing usage, average debts have increased by 35%.[2] These increases are alarming, and if anything, reflect a worse scenario than was envisaged in November 2020 when the decision to apply a $6 per customer allowance was made. While it is hoped that retailers will be able to begin to recover some of these debts as the economy recovers and emergency interventions are withdrawn, this is not certain, and it is highly likely that bad debts will remain high for some years to come.

The increase in customer debt is symptomatic of a retail market that has seen dramatic interventions in recent years. The AEC recently undertook a research consultancy with Synergies Economic Consulting to ascertain the impact of interventions on the retail market design in the NEM.[3] Synergies identified that there had been 34 interventions in the retail market since 2010, with a considerable percentage of these affecting the ability of retailers to recover debts incurred. While additional protections are in many circumstances warranted and can benefit consumers, the AEC considers that the ESC has not effectively accounted for their impact on the ability of retailers to undertake their role in the NEM, namely, to carry the debt and non-payment risk for the entire supply chain. With fewer tools at their disposal, retailers are less able to manage their own risks, and are therefore liable to incurring higher costs than they would have otherwise. This appears to be coming to fruition with the proliferation of debt across the sector, apparently directly related to the emergency interventions of 2020.

The AEC maintains that the risk environment retailers are operating in is not reflective of the environment that the ESC benchmarks against in other jurisdictions, which in many instances, was for a time period prior to these interventions occurring.

The length of the regulatory period

The AEC supports a six-month VDO, from 1 January 2022 to 30 June 2022. A longer period with a reset to factor in any changes to network prices is untenable, as has been highlighted by the ESC's challenges in implementing a price reset to account for network price changes in July 2021. In short, an 18-month VDO would greatly increase the risks faced by retailers and consumers, for little overall benefit given a price change would need to occur after 6 months in any event.

Wholesale cost impacts from a shortened regulatory period

However, the AEC considers that the necessary six-month regulatory period will bring with it additional challenges over a standard full year approach. A six-month period, in particular a period from 1 January to 30 June, will see higher wholesale costs, than would be present in a period from 1 July to 31 December. This means a methodology that simply divides an annual wholesale cost by two would see retailers under-recover costs in the first half of the year, that they will be unable to recover in the second half of the year given the wholesale costs will be reset at this date.

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2 https://www.esc.vic.gov.au/sites/default/files/documents/A%20year%20in%20review%20%E2%80%93%20supporting%20energy%20customers%20during%20the%20coronavirus%20pandemic.pdf

3 Synergies Economic Consulting, Balancing act – Protecting Consumers in a viable retail energy market, February 2021

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This outcome would be inconsistent with the ESC's stated intention that retailers are fairly compensated for costs they incur in providing electricity to VDO customers. While the AEC does not yet have a preferred approach to rectifying this issue, it considers the ESC should direct its consultant, Frontier Economics, to consider alternative approaches to present to industry at a later point in the consultation. These approaches should include consideration of an additional allowance in the 2022 VDO to factor in these additional costs.

The AEC looks forward to continuing to work with the ESC as it further develops the 2022 VDO. 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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