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17 June 2021

Ms Kate Symons
Chairperson
Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC 3000

Submitted electronically

Dear Ms Symons,

Re: Next steps for the Victorian Default Offer

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to make a submission to the Essential Services Commission's (the Commission's) consultation on a proposed approach for the Victorian Default Offer (VDO) to apply from 1 January 2022.

The Commission proposes few changes to its established methodology for determining the VDO and we support this approach. To this point, the Commission has largely struck the right balance between offering a reasonable VDO price for consumers who are unwilling to participate in the competitive market or those who choose the VDO, while allowing retailers to recover reasonable costs. The Commission has also demonstrated a willingness to account for unforeseen challenges, the most notable being the inclusion of an allowance to account for higher bad debt provisioning in 2021. We encourage the Commission to continue with this pragmatic approach as it will facilitate effective retail competition, which is to the benefit of Victorian consumers.

Bad debts

As evidenced in the voluntary data retailers have provided, current debt levels among residential and small business consumers in Victoria remain elevated relative to their historical levels. In our view and experience, this is largely the result of regulatory action that prevented normal debt collection practices which already had strong customer protections for those who need it. Further, this has resulted in more customers deprioritising electricity bills in favour of other bills (such as telecommunications) and retail spending which, as is well documented, has proved to be very strong. The lack of consequence for non-payment has driven higher debt balances, increased aging of debt and therefore higher and significant risk of subsequent collection for retailers as collection activities return to normal.

Under the Payment Difficulties Framework, where customers engage with us, a failure to pay energy bills often reflects genuine payment difficulty. It is unfortunate but disconnection warning notices (and in rare instances disconnection itself) are effective triggers for engagement and as a mechanism for consumers to obtain the support to which they are entitled.

Within this context, the extent of debt and bad debt provisioning for 2022 remains highly uncertain. Given the caution with which our collection processes are returning to normal, and the very low threshold of what customer engagement means still preventing normal activity, debt balances are expected to continue to grow and age further over the winter. We strongly encourage the Commission to remain open to the idea of retaining and/or adjusting the additional allowance for the next VDO, rather than ruling it out at this early stage. The Commission is continuing to receive information about debt from retailers through their voluntary data requests and retailers will be able to provide forward estimates of bad debt provisioning in line with relevant accounting standards.

We also encourage the Commission to account for bad debt provisions across the entire retail sector, rather than focusing on specific retailers (e.g. larger retailers with a diverse customer base).

Retailer risk

It is clear that retail operations in Victoria are subject to much greater regulatory risk than in other jurisdictions. There is merit in the Commission re-considering the premium for Victorian retailers as there are numerous Victorian-specific interventions that are not replicated in any other jurisdiction.

Retailers have previously referred to numerous regulatory interventions that illustrate the volatile nature of the framework in Victoria. Uncertainty about the form and duration of additional emergency COVID support for residential and small business consumers is a recent example. We have also referred to legislative amendments that allow the Minister to introduce new licence conditions for Victorian retailers that effectively creates a parallel framework to the Commission's administration of the Energy Retail Code. Fundamentally replicating an existing framework is costly and unnecessary.

Further, the Commission needs to consider the additional risks associated with the new penalties that are set to apply from 1 January 2021 in under legislative changes that are before parliament and those that are currently being drafted by the Department of Treasury and Finance. We note that legislation currently before parliament intends to introduce a new \$1 million penalty, while a strict liability offence removes the requirement to establish fault. This means retailers could face significant financial penalties where a disconnection is due to human error, rather than the result of its stated purpose of discouraging reckless and wilful disconnections (which no retailer would ever engage in). Retailers have previously raised concerns about the increased risk of customers being disconnected due to the new switching rules as they will have reduced ability to cancel disconnections currently underway since they

won't receive notifications in advance of an impending switch. These increased risks need to be accounted for in the VDO from 2021.

More recently new risks to a retailer's cost recovery arise from the shift in timing of the VDO and restrictions to customer price increases once per year. Network charges for example are increasing materially once again from 1 July, while the VDO will be adjusted two months later. Renewable energy target scheme costs continue to be set on a calendar year basis, but typically only defined in April, and are notoriously difficult to estimate even by the Clean Energy Regulator itself. Cost allowances for such charges in a VDO defined in June create risk of under recovery for a retailer for the first six months of the next calendar year. These increased timing risks also need to be accounted for in the VDO from 2021.

Productivity factor

Red and Lumo see no sound quantitative basis for adjusting the retail operating cost component of the VDO for productivity improvements. Therefore, we agree with the Commission's proposal to adjust the retail operating cost component in line with the Consumer Price Index. We also agree with the Commission's statement that there has been significant market volatility and disruption to retailers' operations from the coronavirus pandemic, and it is more appropriate to analyse the benchmark once market conditions have stabilised. We also note that Red and Lumo's labour costs represent a material component of a retailer's costs and the legislated increase in the level of the superannuation guarantee will likely result in labour costs increasing at more than CPI over the next few years.

Length of regulatory period

Red and Lumo's strong preference is for the next VDO to apply for 6 months. This will align the determination dates for the VDO with distribution network determinations as close as possible, overcoming the need for intra-period adjustments when the Australian Energy Regulator approves new network tariffs. The current misalignment creates significant operational disruption, while there is also uncertainty about retailers' ability to amend market offers due to different provisions in the Energy Retail Code. The Commission wants to provide price certainty to consumers, while allowing retailers to recover higher costs (i.e. network costs in this case), as soon as possible after they start to occur. However, the misalignment creates uncertainty as clause 46AA of the Code currently states that retailers can amend market offer prices 4 weeks after network tariffs change *and* 4 weeks after an intra-period VDO variation. These are different dates in 2021.

We acknowledge that a 6 month determination period leads to 3 changes to the VDO over an 18 month period. Therefore, the Commission and Government should clearly explain to consumers why they are making these changes.

Wholesale cap contracts

The Commission's proposed approach to including new cap contracts based on 5 minute settlement is appropriate and we await the Commission's draft determination to assess whether it produces a reasonable estimate of a prudent retailers' wholesale costs.

About Red and Lumo

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

Red and Lumo thank the Commission for the opportunity to respond to its consultation paper. Should you wish to discuss aspects 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". The signature is stylized with loops and a long horizontal stroke at the end.

Ramy Soussou
General Manager Regulatory Affairs & Stakeholder Relations
Red Energy Pty Ltd
Lumo Energy (Australia) Pty Ltd