Meridian Energy Australia Pty Ltd
Level 15, 357 Collins Street
Melbourne VIC 3000

20 October 2020

Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne, Victoria 3000

Email: www.engage.vic.gov.au

Victorian Default Offer to apply from 1 January 2021 Draft Decision

Meridian Energy Australia Pty Ltd and Powershop Australia Pty Ltd (MEA Group or Powershop) thanks the Essential Services Commission (ESC) for the opportunity to provide comments on the ESC's Victorian Default Offer (VDO) to apply from 1 January 2021 Draft Decision Paper (the Paper).

Background on the MEA Group

The MEA Group is a vertically integrated generator and retailer, with a focus on renewable generation. Through our investment in new generation, we have continued to support Australia's transition to renewable energy. Powershop is an innovative retailer committed to providing lower prices for customers and recognises the benefits to customers in transitioning to a more distributed and renewable-based energy system. Powershop has introduced numerous new, innovative, and customer-centric initiatives into the market.

Statement

MEA Group supported the ESC's 2-month, extended consultation prior to publishing the draft decision, aimed at understanding the impacts of the pandemic and other changes to relevant costs. MEA Group are concerned that the impacts that COVID-19 has had, and will increasingly have, on customers and industry alike, have not been adequately considered in the Paper.

MEA Group understands that the ESC must ensure the VDO is a fair price for all Victorians, based on the efficient costs of the sale of electricity by a retailer. However, a fair price also needs to consider the viability of the supply system in these unprecedented economic times. MEA Group would urge the ESC to consider forecasting the impacts of the pandemic on the efficient costs of the sale of electricity by a retailer. Understanding that there may be challenges in forecasting the impacts of COVID-19 on underlying costs, MEA Group agree with the ESC that the VDO should be reviewed as soon as material impacts are identified.

MEA Group's submission to the consultation paper previously advised that retailers carry and will continue to carry "the significant credit risk, of the entire energy value chain, through increases to bad and doubtful debt and provide increased support and assistance to our customers and the Victorian public through the pandemic and beyond. The change in the risk profile of retailers across the industry must be reflected in the next VDO determination."[1]

While MEA Group are pleased that the ESC are considering the impact of the pandemic, MEA Group would urge the ESC to develop a methodology to forecast of the impact of COVID-19 on costs faced by an efficient retailer, based on data provided through existing reporting.

[1] MEA Group submission, Victorian Default Offer to apply from 1 January 2021, Page 1

MEA Group considers it important that competition in the Victorian electricity retail market remain healthy and be unaffected by VDO determinations. VDO determinations where underlying costs are not correctly accounted for are likely to impact the retail electricity market negatively, ultimately worsening outcomes for consumers. MEA Group, and the industry has remained open and transparent to supporting customers impacted by the pandemic and would expect similar flexibility in VDO determinations.

The pandemic

MEA Group noted in our response to the ESC's consultation paper that there is merit in reassessing the underlying costs faced by an efficient retailer, taking into account the pandemic. The methodologies used to forecast relevant elements of the cost stack were developed before the impact of the pandemic and thus, need to be reassessed to take into account of what has been the sharpest fall in GDP in the last 60 years.

MEA Group would highlight that industry has provided voluntary reports to the ESC throughout the course of the pandemic. These reports were developed to provide the ESC data on the impacts of COVID-19 on retailers and consumers. While MEA Group understand that the ESC has not been able to identify material net costs to energy retailers through this data, MEA Group's internal forecasts indicate otherwise.

The Federal Government has responded to this situation in the first half of 2020 by implementing an unprecedented program of income transfers, wage subsides and early release of superannuation. This has been estimated as resulting in a $41 billion gain in household cash flow, which more than offsets an estimated $17 billion reduction arising from lost wages and unincorporated business income. However, as noted by the Federal Treasure in the recent budget speech, these measures are temporary.

These initial measures have more than protected household income but were fuelled by the early superannuation withdrawal scheme (which has now ceased) and income support measures (Job Keeper and Job Seeker) which are now reducing. This level of income support has meant that many retailer's debt books were not significantly impacted in the period to June 2020. But as household cash flow reduces, noting that the Job Keeper wage subsidy ceases in March 2021, retailer's debt books will deteriorate, and the experience of debt write offs will increase.

In setting the VDO for 2021 the ESC should avail itself of the economic forecasts of the Victorian Treasury Department as well as those of the major banks and well-regarded independent economists. A failure to adequately reflect the demonstrable increase in bad debt risk in the VDO will potentially threaten the viability of some retailers and the level of support that the industry can provide to its customers suffering payment difficulties.

MEA Group are cognisant that there are challenges in accounting for the pandemic in determining the VDO price to apply from January 2021. MEA Group consider that there are 2 options available to the ESC;

1. Develop a methodology to forecast of the impact of COVID-19 on costs faced by an efficient retailer, based on data provided through existing reporting.
2. Ensure that the mechanism to vary the VDO price determination is utilised as soon as the pandemic's impacts on the relevant costs is realised.

Proposed length of regulatory period and variation mechanism

MEA Group understands the ESC's decision to apply a 12-month regulatory period. MEA Group's preference, in line with the broader industry, is for an initial 6-month regulatory period.

MEA Group understand that the ESC is required under the Order in Council (OIC) to provide price certainty. While the OIC does require a 12-month price period, MEA Group understand that alignment to the new period for network pricing will break this requirement, either now or in future. MEA Group is concerned that retailers and consumers will bear the risk of the VDO regulatory period and the network pricing period not aligning.

MEA Group would expect the ESC to apply any known final network prices, confirmed by the AER by 21 May 2021. Any outstanding final network prices can be forecast into a 30 June VDO price with adjustment if necessary, applied for the following VDO. This would be a much cleaner, more consistent outcome. MEA Group would also support the Paper and its option to vary the VDO to accommodate any change to network prices that were not available at the time of finalising the VDO.

A secondary alternative would be to apply the Australian Energy Council's (AEC) approach of a VDO period where prices can be set for 1 August 2021, for a follow up VDO on 30 June 2022, minimising future regulatory burdens or costs.

Productivity factor

Although the ESC has wisely deferred to apply such a factor for the 1 January 2021 VDO, MEA Group believe applying such a factor has little relevance to the retail market we operate in and therefore we believe further consultation with industry would need to occur in order to confirm if this would be beneficial or a cost to consumers.

MEA Group agree with the AEC's submission that a productivity factor would be applicable if this was a monopolised, regulated market, such as water in Victoria. However, we participate in a very competitive market and operate consistently absorbing individual costs that are not allowed to be recovered under the VDO. In addition, it is inappropriate to apply to a business where there is no guarantee on the size of our customer base, only creating further costs and risk burdens for our business.

Conclusion

MEA Group understands that the VDO is not intended to impact a retailer's ability to operate in the Victorian market. MEA understand that the ESC may be unable to forecast for COVID-19 impacts or introduce a 6-month regulatory period for the VDO to apply on 1 January 2021. MEA consider that it is vital that the ESC utilise a mechanism to review the VDO sooner if network costs change on 1 July 2021, or if costs related to COVID-19 are realised.

If you have any queries or would like to discuss any aspect of this submission, please do not hesitate to contact me.

Yours sincerely,

Jason Stein
Chief Executive Officer
Powershop Australia Pty Ltd
Meridian Energy Australia