3 February 2022

Ms Kate Symons
Chair
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne Victoria 3000

Email: VDO@esc.vic.gov.au

Dear Ms Symons

**RE: 2022-23 Victorian Default Offer – Consultation**

Origin Energy (Origin) appreciates the opportunity to provide a submission in response to the Essential Services Commission's (ESC) consultation for the 2022-23 Victorian Default Offer (VDO).

The current economic environment continues to be dominated by COVID-19 concerns and in particular the unanticipated emergence of the Omicron variant. The rise of the Omicron variant and its impact on the economy highlights the difficulty in predicting future economic conditions, including conditions confronting electricity consumers and retailers. It is important that the ESC be mindful of the rapidly changing economic conditions when examining the costs and risks likely to be faced by retailers in the coming year.

Given the shortened consultation period in the lead up to the 2022-23, VDO together with the well-established nature of the VDO methodology, the ESC anticipates maintaining the current approach to setting the VDO. We are broadly supportive of the current approach but reserve the right to update this position as more data becomes available closer to finalisation of the 2022-23 VDO.

As part of the 1 January 2022 VDO, the ESC removed the adjustment for COVID-related bad debt largely on the basis that available information suggested improved economic conditions in 2022. Since making that decision, there has been the emergence of the Omicron variant of COVID-19. The associated quarantining, staffing shortages and supply chain disruptions have significantly impacted economic activity and delayed the anticipated economic rebound from the previous period of extended lockdowns.

These conditions increase financial pressures on both electricity customers and retailers and are expected to adversely impact customer debt. Moreover, the rise of the Omicron variant and consequent impact highlights the fragility of the economic recovery and the pace at which circumstances can change.

The Victorian Treasury 2021-22 Budget Update (the Update) indicates that the risks to Victoria's economic outlook remain greater than normal and current economic forecasts are subject to a high degree of uncertainty. The Update highlights that risks continue to be dominated by the COVID-19 pandemic, including risks around the efficacy of vaccines on emerging strains of COVID-19, and potential changes to policy responses as the domestic and global economies recover.[1]

For example, sensitivity analysis incorporated in the Update indicates that the emergence of a vaccine-resistant COVID-19 strain or further interruptions in global vaccination efforts could result in a protracted

[1] Victorian Department of Treasury and Finance (2021), *Budget Update 2021-22*, p.18.

global recovery and reduce Victoria's gross state product by 0.65 percentage points in 2022-23 and 0.73 percentage points in 2023-24.[2]

We note also that the impact of the Omicron variant on the economy has not been uniform. For example, supply chain constraints have impacted some industries (e.g. construction) to a greater extent, while others such as retail and hospitality have been heavily impacted by labour shortages. To the extent that these types of issues persist, or are exacerbated by future variants, the timing and extent of economic recovery remains highly uncertain.

This presents an ongoing challenge for the ESC in predicting customer impacts and the financial implications for retailers, and thus the development of an appropriate VDO allowance. Reliance on retailers' financial statements to determine future bad debt fails to take account of the constantly changing conditions - these statements are developed at a point in time using available data at that time. Similarly, forecasts of economic growth assume conditions are relatively stable going forward, with any significant disruption to these conditions necessitating a review of forecasts. Faced with a dynamic environment we consider that the ESC needs to remain open in its approach to assessing the impact of COVID-19 and the level of bad debts likely to be incurred by retailers.

We consider that the ESC should seek to anchor its assessment of COVID-related debts on tangible forward indicators. Specifically, we believe that 90 plus day debt levels and the number of customers with 90 plus day debt are closely correlated with bad debt and are likely to provide a reasonably reliable forward indicator of bad debt.

We believe that an increased reliance on retailer debt data is preferable to the use of past financial and economic forecasts in determining future bad debt levels. 90 plus day debt levels and the number of customers with 90 plus day debt provide an indication of potential bad debt in the short-term. In addition, the relative debt level and the trend in 90 plus day debt provide an indication of potential bad debt in the medium-term. While we appreciate that 90 plus day debt data is not a perfect predictor of bad debt, it possesses a number of positive attributes - it is readily available, observable, unbiased and not subject to revision should COVID-19 conditions change. Given these characteristics, we consider that the ESC should rely more heavily on 90 plus day debt data and supplement this with the broader financial and economic indicators as appropriate.

It is incumbent upon the ESC to capture costs as a result of COVID-19 in the retail cost allowance. Failure to incorporate the legitimate costs incurred by retailers would be unfair to retailers and inconsistent with the requirement to determine efficient retailer costs as set out in the pricing order.

If you have any questions regarding this submission, please contact Gary Davies in the first instance at gary.davies@originenergy.com.au.

Yours sincerely

Sean Greenup
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[2] Ibid., p.164.