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8 October 2021

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

Submitted electronically

Dear Ms Symons,

Re: Draft decision - 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) draft decision for the Victorian Default Offer (VDO) to apply from 1 January 2022. We support the Commission's continuation of an established and transparent approach to setting the VDO as this provides certainty for retailers and other stakeholders.

We welcome the Commission's pragmatic approach to adjusting specific elements of the cost stack when regulatory timeframes are misaligned, in particular where there is clear and quantifiable evidence that a significant adjustment is warranted. Notable examples are the Commission's decision to include an additional allowance for the difference between the forecast small-scale technology percentage used in the 2021 VDO and the actual binding small-scale technology percentage for 2021. True ups after retailers have incurred costs—which also include the cost of the Reliability and Emergency Reserve Trader scheme—are an imperfect approach but we acknowledge the Commission's preference to rely on transparent, rigorous and market-based data and forecasts as far as possible and that this is not always available for specific cost items.

In the case of network costs, we support the Commission's proposed approach for the recovery of network costs arising from the misalignment of new network tariffs on 1 July and the revised VDO on 1 September.

Retention of additional allowance for bad and doubtful debt

The Commission has access to quantifiable and accurate information about retailers' current debt levels. We encourage the Commission to continue its pragmatic approach and retain the additional allowance into the next VDO. The data to which the Commission refers in the draft decision as a reason to remove the allowance are backward looking and not representative of the broader retail sector, as it reflected a more optimistic view of how the economy will recover from the pandemic.

It is now clear that the environment has changed and that macroeconomic circumstances have deteriorated. We anticipate this will continue to be felt well into 2022 and exacerbated by the withdrawal of financial support from governments. This is further evidenced by ongoing restrictions on economic activity (the precise nature of which is highly uncertain) and limits on movements across state borders. The public response to vaccine mandates may also impact employment and hours worked, and income levels by implication. In short, the recent build up of debt will endure well into 2022 and the Commission is aware that the longer debt is held, the less likely it is to be recovered.

Retailers' ability to manage their bad debt exposure is limited by the Victorian Government and Commission's (entirely reasonable) limitations on debt management activities. This reflects electricity's status as an essential service but as a consequence, it is also reasonable for regulated prices to account for the ongoing support for vulnerable community members that retailers are providing. Despite the suggestion of some stakeholders at the Commission's recent public forum, retailers are explicitly prevented from directly managing this risk because of regulatory interventions so the *incremental* bad debt is analogous to network costs.

Our previous submission to the Commission's consultation on the 2021 VDO noted that the absence 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. We also stated that although it is unfortunate, 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. This has been proven as fact through data provided to the Commission by retailers.

The Commission's recent *Victorian Energy Market Update* shows early indications that debt remains at relatively high levels. It states that '*the average arrears at the end of June 2021 was seven per cent higher compared to the monthly average in 2019 for electricity, while the average arrears for gas was similar to the monthly average in 2019*.'[1] The Commission is continuing to receive voluntary and obligatory data from retailers which illustrates this. We are also able to provide evidence of the ongoing impact of the pandemic in terms of the volume and age of our debt exposure. We will contact the Commission following lodgement of this submission and provide information confidentially. The future release of key economic indicators—such as unemployment, participation rates and hours worked—ahead of the final determination is further information that we fully anticipate the Commission will consider.

Treatment of environmental costs

Ongoing uncertainty about the Commission's treatment of the cost of complying with the Victorian Energy Upgrades scheme is causing considerable disruption to Victorian retailers. While the impact of the pandemic on certificate creation is well understood, each retailer has managed their exposure to these costs in different ways over the past 12 months in the reasonable belief that the Commission would continue to use the same approach to estimating efficient costs and that the broader policy settings would remain the same. The disruption to certificate creation and any subsequent policy response is beyond retailers' control so it is reasonable for the VDO to account for this unforeseen impact.

The Commission has advised that it is working with the Government to resolve this issue, given both entities have responsibilities to implement potential solutions. Red and Lumo encourage the

[1] Essential Services Commission (2021), *Victorian Energy Market Update*, page 6

Commission and the Government to resolve this issue and to communicate the outcome to retailers and other stakeholders as quickly as possible.

In terms of the treatment of these costs under the VDO, any significant change from current policy settings has the potential to generate either windfall gains or losses for retailers depending on how they have managed their position. Therefore, we encourage the Commission to consult with a representative sample of retailers who will be able to provide confidential information on how any change to current policy settings will impact them and for it to account for this in the final VDO determination. Another alternative is for the Commission to continue with its current approach and account for any substantial change through a true up mechanism in the next VDO.

Support for 6 month determination

The Commission's decision to set this VDO for 6 months—which we strongly support—gives it the opportunity to reassess whether the additional bad debt allowance should be retained in the second half of 2022, by which time we are hopeful that debt will be returning to historic levels.

In terms of the length of the determination, it is important to rectify the misalignment between network and VDO determinations as quickly as possible, even if it means that standing offer customers will experience 4 price changes over an 18 month period. The Commission, or Government, could consider ways of explaining the reasons for the frequency of VDO changes to these consumers, particularly where it has limited retailers' ability to change market offers under a policy of ensuring price stability.

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 1.1 million customers.

Red and Lumo thank the Commission for the opportunity to respond to its draft decision. 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

Ramy Soussou
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