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Mr Mark Feather
General Manager, Policy and Performance
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email: DMO@aer.gov.au

9 April 2020

Dear Mr Feather,

Default Market Offer Price 2020-21 – COVID-19 impact

We refer to the letter dated 31 March 2020 from the Australian Energy Regulator (AER) in relation to the impact of COVID-19 on the determination of the Default Market Offer (DMO) Price for 2020-21. We appreciate the opportunity to provide further information for consideration.

As a leading energy provider, AGL is committed to supporting our customers during this pandemic. On 27 March 2020, we announced the AGL COVID-19 Customer Support Program for customers who may be under financial stress as a result of the pandemic. This program includes:

- Fast-tracked access to a program allowing deferred payments until 31 July 2020.
- Customers also have access to a payment plan that allows them to pay in instalments.
- No disconnections for customers in financial stress during the deferred payment period.
- Waiving disconnection and reconnection fees for small businesses that have been forced to temporarily close.
- Maintaining AGL's existing priority service to customers on life support.

This new program is in addition to AGL's well-established hardship programs. It is consistent with the AER's Statement of Expectation on energy businesses in relation to COVID-19.

As noted by the AER, the scope and scale of COVID-19 are uncertain. Whilst it is obvious that there will be additional costs, it is unclear how long the downturn in business activity and employment will last and the extent of the downturn. Accordingly, AGL has modelled a range of scenarios. It is already evident that demand for energy has softened with spot and forward wholesale prices falling. A range of cost categories will be impacted, with bad debts particularly expected to increase significantly.

Due to the restrictions on movement and work from home arrangements, residential consumption is expected to increase while business usage declines. It is likely that the model usages for residential and small business customers are no longer appropriate. In particular, the model annual usage for small business customers of 20,000 kWh which AGL already considers to be too high, will not be representative. However, for the purpose of re-setting the DMO, maintaining some consistency is important and changes in model usages will have significant impact on reference billing arrangements currently in place and should be avoided.

While the impact of COVID-19 is still developing, for the purposes of re-setting the 2020-21 DMO, the areas to review are wholesale energy costs and retail operating costs. This is discussed further below.

Wholesale energy costs

ACIL Allen's modelling of wholesale energy costs uses a market-based approach so that the recent declines in forward contract prices will be incorporated into the DMO. AGL accepts that this is appropriate.

The sudden reduction in business activity and employment from March 2020 will result in changes in the mix of residential and business demand as total demand reduces. Lower business sales will be partially offset by higher residential sales. As retailers are likely to have already contracted hedge cover for 2020-21 by March 2020 on the basis of forecast demand, retailers will be over-hedged for the next financial year. This volume risk is unlikely to be fully accounted for in the ACIL Allen modelling. AGL considers that there should be recognition that retailers will incur additional wholesale costs as a result of the unexpected decline in demand.

Retail operating costs

AGL has assessed the impact of COVID-19 on some cost categories, particularly on bad debts. Bad debts include debt write-offs and provisions for doubtful debt, net of debt recovered.

To assess the impact on net bad debt expense, AGL has modelled a range of scenarios including assumptions on the amount of overdue bills, customers accessing the COVID-19 support program, collection activities, disconnection policies and debt provision rates. These scenarios are assessed by considering the downturn with different magnitudes and over various periods of up to 6 months. (It should be noted that even if the restrictions are lifted, it is unlikely that business activity and employment will return fully to the levels prior to the restrictions. The impact of this step down in economic activity over the longer term has not been considered).

While these scenarios produce a wide range of financial outcomes, we have provided information to the AER in a confidential attachment to provide a guide on the possible impact of COVID-19 on retail businesses that should be included in the 2020-21 DMO.

Under the approach the AER will adopt for the DMO, this increase in bad debts will be represented as a step cost change in 'residual costs', in addition to the CPI adjustment.

It should be noted that there are also increases in operating costs including higher call volumes and provision of office equipment, upgrades to IT and telecommunication capabilities as result of working from home arrangements. In addition, tasks may take longer or be more complicated if third party providers are involved under the current circumstances. These costs are currently difficult to track and have not been included.

Forecasting the impact of COVID-19 is uncertain at this time so AGL accepts that it may be appropriate for the AER to review any allowance provided to residual costs and consider making post-event adjustments if required.

If you have any questions in relation to this submission, please contact Meng Goh, Senior Manager Regulatory Strategy, on mgoh@agl.com.au or (02) 9921 2221.

Yours sincerely

Elizabeth Molyneux
General Manager Energy Market Regulation