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Default Market Offer Price 2021-22 Position Paper

Meridian Energy Australia Pty Ltd and Powershop Australia Pty Ltd (MEA Group or Powershop) thanks the Australian Energy Regulator (AER) for the opportunity to provide comments on the AER's Default Market Offer Price 2021-22 Position Paper (the Paper).

Background on the MEA Group

MEA Group is a vertically integrated generator and retailer focused entirely on renewable generation with generation assets including the Mt Millar Wind Farm in South Australia and the Mt Mercer Wind Farm in Victoria. Our portfolio also includes the Hume, Burrinjuck and Keepit hydroelectric power stations, further expanding our modes of generation. We also hold a number of power purchase agreements with other renewable generators, and through this investment in new generation we have continued to support Australia's transition to renewable energy.

Powershop is an innovative retailer committed to providing low prices for customers and which recognises the benefits to customers in transitioning to a more distributed and renewable-based energy system. Powershop has introduced innovative and customer-centric initiatives into the Victorian market, including the first mobile app that allows customers to monitor their usage, a peer-to-peer solar trading trial and a successful customer-led demand response program.

Statement

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 AER must provide a Default Market Offer (DMO), designed to meet its policy objectives to:

- Prevent retailers from charging unjustifiably high standing offer prices;
- Allow retailers to recover their efficient costs of providing services, including a reasonable retail margin; and
- Not reduce incentives for competition, innovation and investment by retailers, and should retain incentives for consumers to engage in the market.

However, a fair price also needs to consider the viability of the supply system in these unprecedented economic times.

The Pandemic

MEA Group are pleased that the AER are seriously considering the impact of the pandemic using data provided through existing and recent reporting. MEA Group urges the AER to continue to consider the impact as it evolves over time. Understanding that there may be challenges in forecasting the impacts of COVID-19 on underlying costs, MEA Group would recommend that the AER review the DMO as soon as material impacts are identified and not delay any changes until the next review in late 2021. Such a delay would significantly increase the risk that any cost increase could be unfairly borne by retailers.

MEA Group made a submission to the Essential Services Commission of Victoria for its 2021 VDO advising 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] One of the policy positions of the DMO is to allow retailers to recover their efficient costs of providing services. As the industry is likely to encounter sustained and substantial increases to the cost of providing service, MEA Group consider that the DMO must reflect the likely increase in these costs.

MEA Group's view is that there is merit in reassessing the underlying costs faced by a retailer due to the pandemic. While MEA Group is supportive of the ongoing indexation approach, the impacts of COVID are likely to be borne increasingly by customers and the retailers they contract with during the next DMO period. The cost stack methodology was developed well in advance of the pandemic and thus, need to be reassessed to ensure it takes into account what has been the sharpest fall in GDP in the last 60 years.

Upon request, MEA Group provided voluntary reporting to provide the AER data on the impacts of COVID-19 on retailers and consumers. While MEA Group understand that the AER has not been able to identify material net costs to energy retailers through this data, MEA Group would encourage the AER to continue to consult with energy businesses on trends and increases in underlying costs over the coming months, leading up to the 2021/22 DMO determination.

The Federal Government in the first half of 2020 implemented an unprecedented program of income transfers, wage subsides and early release of superannuation, resulting in an estimated $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, these measures are only temporary.

These initial measures have more than protected household income. However this was 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 DMO for 1 July 2021 the AER should avail itself of the Federal Treasurer's national economic forecasts 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 as a part of a retailers efficient costs over the next year or so, would be a failure to achieve the policy ojectives of allowing retailers to recover efficient costs, plus margin and to still encourage innovation, investment and competition.

MEA Group understand that there are challenges in accounting for the pandemic in determining the DMO price. However, the DMO will not be struck until 1 May 2021. By this time, all network pricing will be final, and a clearer picture of the level of bad debt retailers accrue, post-cessation of government assistance, will likely be available. Leading up to the final determination in May, MEA Group encourages the AER to further develop a methodology to forecast the impact of COVID-19 on costs faced by retailers using the data provided.

Please find below our responses to the questions raised in the Paper.

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

Section 3.1 – Pricing methodology for DMO 2021-22

1. Do you agree with the principle that forecasts and assumptions from previous DMO determinations should not be retrospectively amended to reflect actual information?

MEA Group supports this principle.

Section 3.2 - Forecasting changes in the cost of supply

2. Does our assumption of a risk averse retailer building their hedge book from the time of the first trade recorded by ASX Energy remain appropriate, or is a shorter period justified? What is an appropriate period and why?

The methodology underpinning the DMO should now be mature to adopt an approach that reflects as close to actual costs as possible. This would achieve the policy objectives of the DMO.

8. Do you agree with our proposed approach to continue using the DMO 2 network costs methodology?

MEA Group consider that, in the previous DMO determination (2020/21), indicative network tariff prices were used in the calculation of network costs. MEA Group understand that these indicative prices were used in the final DMO determination due to a delay in the approval of final network prices from Energex and South Australia Power Networks. The use of indicative network prices in this case resulted in a misallocation of the true network costs incurred by retailers in the current DMO.

The Paper outlines that the AEC is considering options with the AER to ensure that final prices from all networks can be applied in the determination of each DMO. MEA Group proposes a simplistic approach for the AER to propose a rule change that would require network businesses to submit final proposed pricing by a defined date, in order for the AER to align the network pricing approvals and the DMO price determination.

9. Is it reasonable to apply a productivity factor to the DMO? What is the evidence retailers' costs are decreasing or increasing?

MEA Group encourages the AER not to apply a Productivity factor as disclosed in the Paper for any future DMO. A productivity factor is not relevant to the DMO, where it is not necessarily intended to be a true reflection of retailer's costs or gains in productivity. This proposal would be in stark contrast to the policy position where the DMO should not reduce incentives for competition, innovation and investment.

MEA Group believe applying such a factor has little relevance to the retail market we operate in and 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 Australian Energy Council's (AEC) submission that a productivity factor would be applicable if this was a monopolised, regulated market. However, we participate in a competitive market and operate consistently absorbing individual costs that are not necessarily accounted for in DMO. A productivity factor is also 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.

10. What form should any productivity adjustment take?

Not applicable.

12. What will be the impact of COVID-19 on retailer costs in 2021-22? Are any retailer costs decreasing due to COVID-19?

MEA Group will provide to the AER the impact on retailer costs specific to our business confidentially.

15. Aside from CDR and COVID-19, are there other regulatory or operating environment changes that are likely to materially increase or decrease retailers' costs to serve customers in 2021-22?

Regulatory changes that are likely to come into effect during 2021-22 include 5 Minute Settlement, Global Settlements, Wholesale Demand Response. These projects are all likely to involve significant financial outlay for the retail sector during 2021-22. MEA Group encourage the AER to work closely with stakeholders to better understand how these projects will impact retailers leading up to the final DMO determination next year.

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

Yours sincerely,

James Ell
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