09 April 2020

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Dear Mr Feather

COVID-19 considerations for the Default Market Offer for 2020-21

Thanks for the chance to provide our views on how we see COVID-19 impacting the Default Market Offer (DMO) for 2020-21. As you say, there are a great deal of unknowns, but there are some outcomes that will directly affect both energy consumers and retailers that are worth raising for your consideration. Of particular importance is finding the best possible balance between supporting energy consumers through this crisis period without placing a disproportionate burden on retailers that could reduce retail competition in the longer term should disorderly retailer exit result.

Supporting Energy Consumers is a Priority

The combination of temporary business closures, reduced working hours, job losses and self-isolation requirements means many Australians are experiencing an unprecedented level of financial uncertainty. Additionally, the requirements to self-isolate at home means most Australians will find themselves consuming more energy on average than would otherwise be the case. This combination means higher energy bills with an overall lower capacity to pay, and therefore an increased risk of customer debt.

Energy is an essential service and with more people based at home, continuing the safe and reliable supply of energy to homes and businesses is critical. Retailers play a pivotal role in providing that first line support to these consumers. This key role has been reinforced by the AER in its Statement of Expectations of energy businesses: protecting consumers and the energy market during COVID-19. We note, however, the burden of providing this protection falls overwhelming on electricity retailers who, whilst affording customers due protection, are afforded no relief in meeting their obligations to AEMO and networks as their principal creditors.

The foundation support for consumers is in the form of a retailer's hardship program. These programs are designed to provide consumers support during financially challenging times. Retailers are set up to facilitate energy concessions, rebate and the various state-based energy assistance schemes programs. The challenge for retailers is managing the demand for hardship programs, in a COVID-19 world, where the number of consumers accessing these programs is expected to be substantially higher than ever before and include a greater spectrum of consumers who may be navigating this position for the first time.

Implications of COVID-19 for Energy Retailers

Yes, retailers have a regulatory obligation to provide support to consumers in financial hardship. Like every other business around the world, however, COVID-19 has unexpectedly increased the financial impact of this obligation. This impact has a few dimensions. First, there is a cash flow impact. With an increased number of customers finding it difficult to pay their energy bills in part or in full, retailers will have increasingly aged and defaulting receivables. This tightening of cash flow impairs retailer's ability to continue to:

- Settle wholesale energy costs, both with AEMO and contractual hedging counterparties;
- maintain or provide increased NEM prudentials; and

- Pay networks on behalf of their customers both daily supply and usage charges (again higher due to increased customer load).

Retailers are consequently likely to start accumulating customer debt at a higher rate than any of us had forecast under business as usual. This is even after making sure their consumers have accessed all the available energy concessions, rebates and support available. We agree with the AER's principles to cease customer disconnections or credit collections during this pandemic. Consumers need confidence regardless of their unexpected financial position, they will continue to have access to power. A consequence of this though, is a need for retailers to finance an increase in debt with limited ability to recover it in the short-to-medium term.

If retailers are left carrying this disproportionate burden, retailer failure could occur, which would not only cause disruption to both the industry and customers, but also reduce retail competition in the longer term should that exit be disorderly.

Considerations for the DMO 2020-2021

We appreciate the AER actively considering the impact of COVID-19 for the energy market across 2020-2021. Here are our views based on the time provided.

Wholesale cost methodology

Leave unchanged.

Whether or not retailers agree with the methodology used to formulate the existing wholesale input costs, COVID-19 is driving a still unknown impact to market demand and therefore wholesale prices. Whatever the impact, however, it is unclear what the impact from July 2020 will be for the market. To try and forecast any supply or demand implications are fraught with such uncertainty, it would be better to leave the existing methodology as is.

Environmental cost methodology

Consider revising.

On 7 April 2020, the Clean Energy Regulator (CER) published a news update on the implications of COVID-19 on the availability of small-scale technology certificate (STC) surrender for Q1 2020. In that update, the CER noted that while it estimated sufficient STCs to meet Q1 surrender, the expectations of a potential fall in both electricity demand and in STC supply means the STC spot price has risen to close to the Clearing House price of $40. This certificate supply constraint is likely to have implications throughout the current crisis and therefore may have longer term implications for the remainder of the SRES compliance year. We encourage the AER to consider this visible impact in its environmental cost methodology of the DMO for 2020-2021.

Anecdotally, we would expect a similar impact is likely in each of the state-based energy efficiency schemes. In a self-isolation environment, it is currently difficult to install energy efficiency equipment in both individual residences as well as small and medium sized businesses. Therefore, the available pool of energy efficiency credits is likely to be impacted and therefore also the price. We would support the AER to consider the real potential of increasing costs of meeting state-based environmental programs in its DMO calculations also.

Happy to discuss further

We thank the AER again for seeking views from industry on the impact of COVID-19. Should you wish to discuss this submission, please contact me using the details below.

Kind regards,

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