8 October 2021

Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

By electronic lodgement: https://engage.vic.gov.au/victoria-default-offer-2022

Victorian Default Offer 2022

Alinta Energy welcomes the opportunity to respond to the Essential Services Commission's draft decision on the Victorian Default Offer for 2022.

Alinta Energy, as an active investor in energy markets across Australia with an owned and contracted generation portfolio of nearly 3,000MW and more than 1.1 million electricity and gas customers has a strong interest in the setting of the VDO for 2022.

We note that the ESC will maintain its past approach to determining the components of the VDO. While the rationale for this is appropriate for some of the elements of the VDO, there is a risk that the draft VDO will be lower than efficient retailer costs for the first six months of 2022 (specifically, wholesale and environmental cost components of the VDO).

Under recovered network charges and length of regulatory period

Alinta Energy supports the ESC accounting for under-recovered network costs and the use of a six-month VDO period to align with network tariff changes for 2022-23.

The alignment of changes to network tariffs with the VDO and the determination of network tariffs in other jurisdictions is an important improvement in the setting of the VDO which Alinta Energy strongly supports. We note that the Australian Energy Regulator is also looking at ways to improve the timing and process to determine network charges. This should provide both the ESC and retailers with future financial year network charges in a timelier manner.

Wholesale costs

We remain of the view that applying a calendar year approach to wholesale costs for the first six months of 2022 will understate an efficient retailer's costs. While the ESC considers its approach is consistent with past VDO determinations, applying a calendar year contract book build will not reflect the wholesale costs incurred by an efficient and prudent retailer in that period.

In addition, the VDO set for 2022-23 will reflect the circumstances of the market at that time and beyond, which is likely to involve the exit of substantial generating capacity (Liddell Power

Station). This may result in a significant difference in the estimate of the wholesale cost component for the first six months of 2022 relative to the subsequent financial year VDO.

Estimating wholesale costs by limiting the analysis period to the first six months of 2022 would smooth the transition to estimation of wholesale costs over the 2022-23 financial year.

<u>Environmental costs</u>

In its draft decision, the ESC has applied a 12-month weighted average of price of certificates under the Victorian Energy Upgrades program to forecast this component of environmental costs in an efficient retailer's cost stack. While we agree that retailer's contract to manage their exposure to changes in certificates under the VEU, we note that the drivers for increased certificate prices (currently close to $80 on the spot market[1]) are systemic and relate to the financial viability of certificate providers and the credit risk of them defaulting on contracted volumes of certificates in the market, which is of growing concern across the industry. In addition, providers engaged in delivering eligible activities for the VEU program have faced challenges accessing customer premises due to the COVID pandemic.

For example, retailers have encountered significant supplier defaults on contracts struck at lower certificate prices and this will continue to occur due to scheme changes and ongoing lockdowns. This then requires retailers to recontract these certificates at higher prices. Because of this, the current methodology is not a fair reflection of a retailers' costs.

We believe in its final decision, the ESC needs to account for these challenges by adding a risk premium to the current approach to estimating VEU costs. While the final decision will reflect the updated 12-month weighted average of certificate prices, this will not reflect the ongoing challenges for retailers and providers to procure sufficient certificates to meet the obligations of the VEU program and it is very likely this element of the retailer cost stack will be significantly understated.

<u>Temporary bad debt allowance</u>

We note the ESC is considering the removal of the $6 per customer bad debt allowance to account for the impacts of the COVID pandemic. Alinta Energy believes it is premature to withdraw the bad debt allowance given that the evidence the ESC has relied upon to justify its removal is no longer current and does not reflect the recent, significant surge in pandemic infections in New South Wales and Victoria and the associated lockdowns impacting business and employment levels. This, combined with the reduction in government support for individuals and businesses would suggest that the underlying conditions supporting the application of a bad debt allowance are perhaps more pronounced than twelve months ago.

The figure on page 31 of the draft decision showing average monthly arrears for customers unable to pay for ongoing usage indicates a stabilisation (not a reduction) in average arrears and it is highly likely that more recent data will show an increase in the level of arrears.

We would emphasise that any analysis of data provided by retailers needs to be considered in light of the steps retailers have taken to protect customers from disconnection and the increased waiver of debt during the COVID pandemic. Some retailer's bad debts have simply been written off and time series of debt levels will not include these amounts.

[1] Demand Manager (2021), see: https://www.demandmanager.com.au/certificate-prices/

Conclusion

We look forward to working with the ESC as it works toward its final decision on the VDO for 2022 and welcome further discussion on any of the matters raised in this response. Please contact David Calder (Manager, Regulatory Strategy) on (03) 9675 5359 in the first instance.

Yours sincerely

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