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

By electronic lodgement: https://engage.vic.gov.au/Victorian-default-offer-2021

21 July 2020

Victorian Default Offer 2021 – Consultation Paper

Alinta Energy welcomes the opportunity to respond to the Commision's consultation paper on the Victorian Default Offer to apply from 2021.

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 determination of the VDO, as a key determinant in the effectiveness of the Victorian energy retail market.

Alinta Energy is generally supportive of the Commission's approach to determining the VDO for 2021. However, in our view, some components of retailer costs and the challenge presented by the COVID-19 pandemic requires careful consideration in the determination VDO from January 2021. There are also elements of the method applied by the Commission that result in a VDO that is not reflective of an efficient retailer's costs and risk profile.

Wholesale electricity costs (WEC)

Setting the WEC component based on the median load weighted price is not appropriate in Alinta Energy's view. The approach recommended by ACIL Allen, where WEC is determined based on distribution of simulated price outcomes, more accurately reflects the risks facing retailers participating in the wholesale electricity market and reflects appropriate mitigation of this risk by an efficient (and prudent) retailer.

Applying the 50th percentile (as Frontier Economics did for the 2020 VDO), implies a retailer would expect to under-recover its wholesale costs 50 per cent of the time. Alinta Energy does not consider a rational retailer would hold a position that produced this outcome and strongly recommend the application of the 50th percentile be revisited for the determination of the WEC in calculating the VDO for 2021.

Environmental costs

The use of a market price approach to determining LRET costs in the VDO does not reflect how retailers prudently manage this component of their environmental costs. Long term contracts and power purchase agreements are often the source of LRET certificate acquisition rather than forward markets alone. A contracts-based approach would more

Alinta Energy Retail Sales Pty Ltd ABN 22 149 658 300
Grosvenor Place, Level 13, 225 George Street, Sydney NSW 2000 Australia
T +61 2 9372 2600 F +61 2 9372 2610 W alintaenergy.com.au

accurately reflect the cost of LRET over time and should be considered in the determination of the VDO for 2021.

Retail operating costs (ROC)

Alinta Energy does not consider relying on the ICRC's 2017 benchmark of ROC is appropriate to determine this component of the VDO for 2021. This benchmark does not incorporate the costs facing retailers to implement significant regulatory changes in Victoria (and in the NEM) in recent years. We support the ESC again seeking ROC data directly from retailers to validate the benchmark and reflect the impact of regulatory reform implementation (including ongoing projects such as five-minute settlement). In addition, the ESC needs to make an allowance for the impact of the COVID-19 pandemic on ROC. While the full impact of the pandemic cannot be accurately determined today, retailers, like other businesses, will face increased operating costs in the short and medium term.

While there are steps retailers may have taken to offset the impact of the pandemic, there elements of ROC for which there is not mitigation. Significantly, this includes the growing cost of bad and doubtful debts facing retailers as the impact of the pandemic on customers and their capacity to pay for energy becomes clearer. Added to this will be the eventual write down of debt and collection activities that are incremental to normal energy retailing activities and costs. Alinta Energy encourages the ESC to examine these costs and make an allowance for the material increases anticipated in determining the VDO for 2021.

Despite the view of the Commission that there may be offsetting wholesale and network factors, in the cost-stack retailers lower wholesale costs may not be accessible where retailers have already hedged at higher prices and accessing the deferral of network costs is likely to be a last resort for most retailers and needs to be eventually repaid to distribution networks.

Alinta Energy appreciates the Commission's willingness to consider the additional costs arising from the pandemic and would stress that the scope and size of the impacts of it on ROC will change dynamically. We discuss the period of VDO application further below but support more frequent review of the VDO to capture the impact of the pandemic.

Alignment of network and retail tariff structures

While generally supportive of cost reflective tariff structures, Alinta Energy does not support increasing misalignment between customers choosing the VDO flat tariff structure while their underlying network tariff comprises a more complex time of use or demand tariff structure.

This misalignment is expected to increase as electricity distribution businesses implement new network tariff structures. We acknowledge the difficulties in developing an 'average' cost reflective VDO (as no two customer's consumption patterns are the same), but while the VDO remains a flat tariff structure, retailers should be able to assign customers to flat network tariff structures where they choose the VDO. Allowing misalignment results in risks retailers are unable to reasonably manage (without imposing additional costs on other customers via inefficient cross subsidies) and does not achieve the objective to change a customer's pattern of use signalled by the network tariff structure.

As the Commission notes on pages 15 and 16 of its consultation paper, customers choosing the VDO as a simple, easily understood tariff structure are less likely to be engaged with the pattern of their energy consumption. Customers who are engaged with the energy market and their consumption are better placed to take advantage of price signals provided by cost reflective tariffs

Customer acquisition and retention costs (CARC)

Alinta Energy supports the continued use of a benchmarking approach to estimate CARC for the 2021 VDO. It is important that an allowance be made for CARC to maintain choice and active competition in the retail energy market.

Other matters - regulatory period of the VDO

Alinta Energy supports the use of the most up to date and relevant cost data where possible in determining components of the VDO. The change in setting network prices from calendar to financial years is a welcome alignment with other jurisdictions. Alinta Energy agrees this presents several options to the ESC in terms of the period the VDO will apply.

While there may be some additional burden for the Commission and industry from an administrative standpoint, the setting of a VDO for the first six months of 2021, followed by an annual VDO determination for the 2022 financial year would:

- More accurately account for network costs for 2021/22; and
- Allow the Commission to consider ongoing impacts from the COVID-19 pandemic and the impact on retail operating costs.

The benefits provided by this approach are preferable to locking into an eighteen-month VDO at a time of significant economic uncertainty due to the pandemic or proceeding without access to actual network costs as a material component of the VDO.

Alinta Energy would welcome further discussion with the Commission on any of the matters raised in this response and looks forward to assisting the ESC with data and information as it finalises its VDO determination for 1 January 2021 and beyond. Please contact David Calder (Manager, Regulatory Strategy) on (03) 9675 5359 in the first instance.

Yours sincerely,

Graeme Hamilton
General Manager, Government & Regulatory Affairs