21 July 2020

Essential Services Commission
Level 37
2 Lonsdale St
Melbourne Victoria 3000

Lodged electronically: www.engage.vic.gov.au

EnergyAustralia Pty Ltd
ABN 99 086 014 968

Level 33
385 Bourke Street
Melbourne Victoria 3000

Phone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@energyaustralia.com.au
energyaustralia.com.au

Dear Commissioners

Victorian Default Offer 2021 – Consultation paper – June 2020

EnergyAustralia is one of Australia's largest energy companies with around 2.5 million electricity and gas accounts across eastern Australia. We also own, operate and contract an energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 4,500MW of generation capacity.

We appreciate the opportunity to engage with the Commission in setting the Victorian Default Offer (VDO) for 2021.

As detailed in the attached, our main responses to the Commission's issues paper are:

- The Commission should be clear in how its VDO prices, including as a reference for market offers, will promote the long-term interests of consumers, having regard to the efficiency and financial viability of the industry, and incentives for long term investment, particularly under foreseeable market conditions.

- Dealing with the risk and cost impacts of COVID-19 will be a joint challenge for the sector to manage over the coming months, over which we expect more information to become available and strategies to assist customers will also evolve.

- We support the next VDO determination running for six months, particularly given uncertainty around COVID impacts and to ensure network price changes are accurately captured.

- The Commission's market-based approach to determining the price of large-scale generation certificates (LGCs), if applied again for 2021, will materially undercompensate retailers for the efficient costs of complying with the Large-scale Renewable Energy Target (LRET).

If you would like to discuss this submission, please contact me on 03 8628 1655 or Lawrence.irlam@energyaustralia.com.au.

Regards

Lawrence Irlam
Industry Regulation Lead

The Commission must have regard to retailer viability and longer-term objectives for the Victorian retail market

Publicly available data suggest retailers are now particularly vulnerable to cost and revenue impacts from COVID-19. The VDO, by being set at an idealised level of efficient costs, has the potential to increase risk of retailer exit and associated disruption for customers. The Commission should be aiming to ensure retailer pricing, cost and profitability is maintained at long-run sustainable levels. Our view is that regulation has a role to play in promoting such outcomes, but where possible they should be ultimately driven by competitive pressures.

We support measures that safeguard disengaged customers from unfair prices, however the framework set out in the VDO Order is incompatible with a competitive market. The Commission must determine a single set of prices for all retailers even though each retailer will have different costs according to their own practices, history and the market segments they serve. As discussed further below in the context of the LRET, it is not yet clear if the Commission has a coherent view of "the" efficient retailer under the Order. In the absence of defining this, the Commission should assess whether its total cost allowances are sufficient to ensure retailers, on average or for particular entities, will recover their expected costs for the determination period, or are otherwise in accordance with its broader legislative objectives.

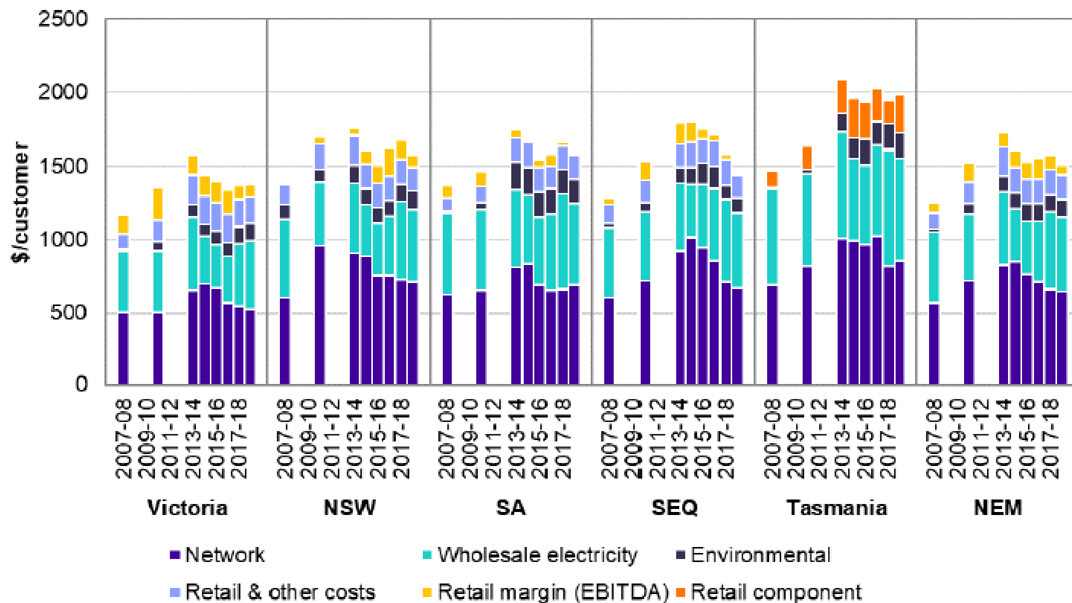
Clauses 12(8) and (9) of the Order state that the Commission is not required to determine tariffs based on a retailer's actual costs or margins. However, these provisions do not mean that retailers' actual costs or margins should be disregarded as being inefficient, or do not provide any useful information in setting benchmark allowances. We consider that the degree of competition in the electricity retail market is a relevant factor the Commission must have regard to under section 8A(1)(c) of the ESC Act. To this end, observed market pricing and profitability, as well as heightened risks due to COVID impacts on revenue recovery, suggests there are enough pressures on all retailers to reduce costs, such that actual costs should be regarded as efficient. Thus far, the Commission has not indicated that it will review the actual cost data that it has and will collect in order to determine whether or not they are efficient, and what information can be drawn from this information in making its VDO determination. Pending any such review, where the Commission's allowances are less than any retailer's actual costs, this may give rise to concerns about satisfying the requirements of clause 12(3) of the Order.

One of the primary concerns leading to the introduction of the VDO, and a reflection of the state of competition more generally, was high retail operating margins.[1] These margins have since dissipated and for 2018-19, across all retailers in Victoria, EBITDA margins were 6 per cent[2], approximating the Commission's benchmark gross margin. This was before the introduction of the VDO which directly reduced standing offer prices and indirectly affected market offers prices. More reforms have been introduced since 1 July 2019 such as 'best offer on bills' and the 'Ensuring Fair Contracts' reforms which, at the very least, will increase retailer compliance costs and, if the reforms are effective, may place further downward pressure on prices.

[1] Note that the Thwaites Review recommendations were not based on any primary or systematic analysis of retail margins. See for example Thwaites et al, *Independent Review into the Electricity & Gas Retail Markets in Victoria*, August 2017, pp. 17-18.

[2] ACCC, *Inquiry into the National Electricity Market - November 2019 Report*, 29 November 2019, p. 4.

Figure 2.13: Average residential customer bills by NEM regions, 2007–08 to 2018–19, real $2018–19, excluding GST



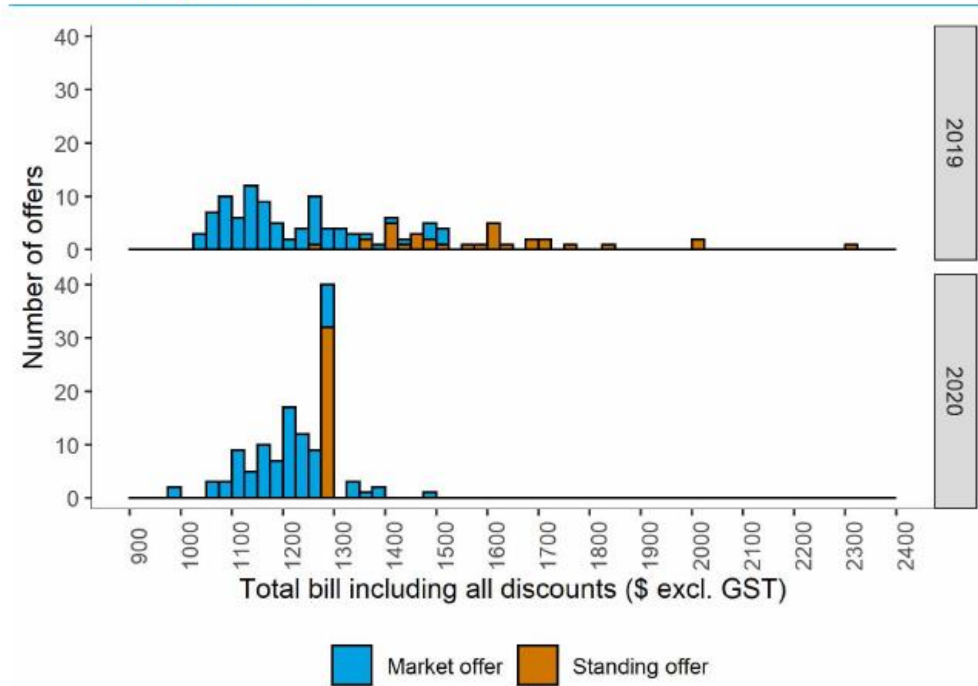
Source: ACCC analysis based on retailers' data.

Source: ACCC, November 2019, p. 41.

The ACCC is yet to gather and publish financial data for 2019-20. Our expectation is that retailer margins have further declined. The compression in prices after 1 July 2019 in all jurisdictions came about through a reduction in higher prices for residential customers, and also with some increases in cheaper offers for small business customers,[3] with the net result almost certainly being a reduction in overall profitability. The figures below reflect pricing data for the Citipower distribution zone and the same trend is reflected in all Victorian distribution networks.

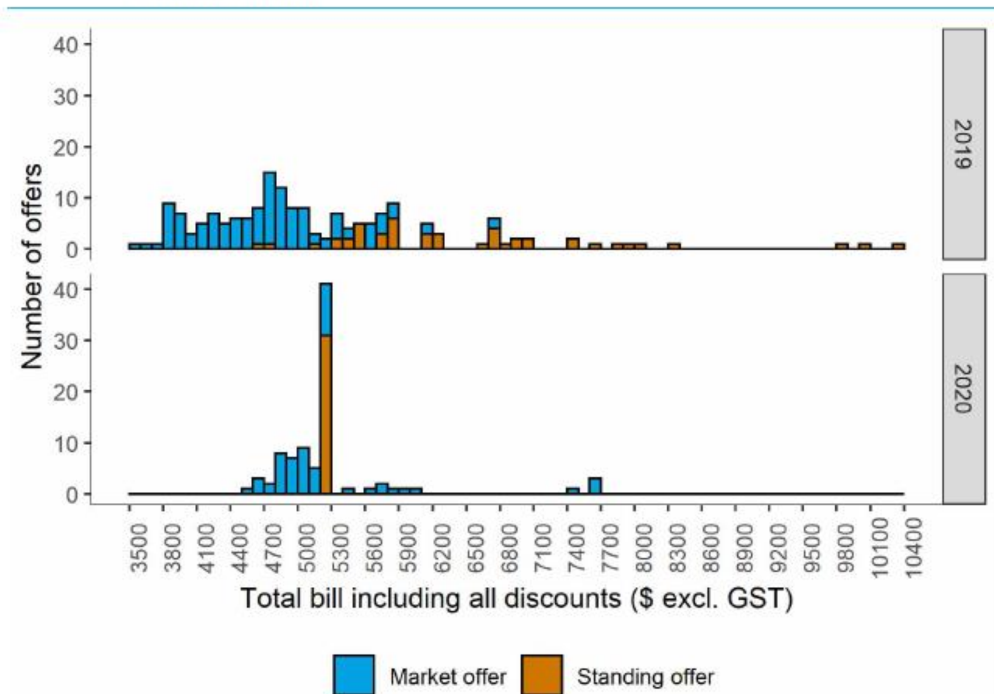
[3] AEMC, *2020 Retail energy competition review - Final report*, 30 June 2020, pp. 51-70.

Figure 4.6: Distribution of representative residential bill offers by retailer type - CitiPower's distribution area



Source: Victorian Energy Compare (accessed 1 March 2019 and 1 March 2020), AEMC analysis.

Figure 4.8: Distribution of representative small business bill offers by offer type - CitiPower's distribution area



Source: Victorian Energy Compare (accessed 1 March 2019 and 1 March 2020), AEMC analysis.

Source: AEMC, June 2020, p. 65.

The Commission presents a more high-level data set for Victorian price outcomes in its consultation paper. It observes that retailers are "still" offering prices below the VDO, in response to arguments that its benchmark margin is insufficient to support competition.[4] As with the AEMC's data, we expect that the majority of market offers are within a few percentage points of the VDO and likely clustered close to the median price.

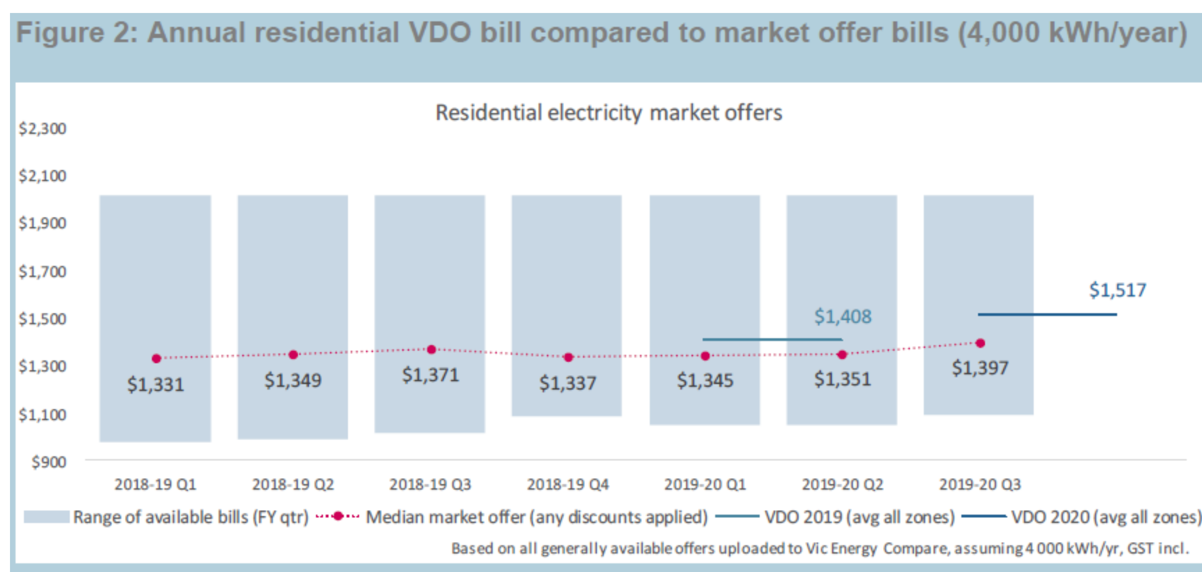


Figure 2: Annual residential VDO bill compared to market offer bills (4,000 kWh/year)

Source: Commission, June 2020, p. 14.

The Commission's commentary appears to presume these prices reflect the efficient costs of the respective retailer. There are many reasons why current market prices and costs diverge and, as noted above, our expectation is that retailers are now earning less than the Commission's benchmark gross margin. Net margins or actual profits are obviously still less than this and may be at unsustainable levels for many retailers. Any presumptions regarding the efficiency or otherwise of actual observed data, i.e. stemming from Clauses 12(8) and (9) of the Order, should be demonstrated.

Aside from the overall level of these prices, the Commission should further explore whether the 'money on the table' from switching between these market offers, and switching from or to the VDO, is worth the customer's effort. From the retailer's perspective, price compression may inhibit incentives to provide better quality services or introduce more innovative products, including those associated with distributed energy resources or novel tariff structures. The Commission's approach to acquisition and retention costs, reflecting the 'modest' requirement under Clause 12(4)(d) of the Order, further limits retailers' ability to market themselves to potential customers and is a further drag on competitive outcomes.

[4] Essential Services Commission, *Victorian Default Offer 2021: Consultation Paper*, 16 June 2020, p. 13-14.

In summary, the above considerations are relevant for the Commission in making its VDO determination because:

- although the VDO sets a cap for standing offer tariffs, it is unlikely that any retailer would set market offers above this amount to recover costs i.e. the VDO is effectively a cap on market offers. This is illustrated by the very small number of market offers above the VDO in the AEMC's datasets
- retailers are likely to be facing pressures to ensure that customers are still presented with large discounts off the reference price, particularly now unconditional discounts have been capped at a few percentage points
- the Commission is now dealing with the heightened risk of retailer failure given uncertain COVID impacts at a time where retailer profitability is already likely suffering
- the Commission must set tariffs based on the efficient cost of a retailer under clause 12(3) of the Order. The Commission may take an alternative view, but we consider 'efficient' to reflect some consideration of long-run sustainable costs which would substantial data analysis to determine
- a comparison of recent market offers to VDO price caps is a useful starting point, however having regard to the financial viability of the industry, for example under section 8A(1)(b) of the ESC Act, also requires consideration of actual and likely profitability.

In making its draft and final determinations, we expect a more fulsome consideration of these matters, particularly as the Commission gathers financial data directly from retailers, and progresses its market review[5] over the remainder of 2020.

We will continue to engage with the Commission regarding COVID impacts

Current information on COVID impacts relating to EnergyAustralia's business is contained in the confidential attachment to this submission. Where we are able, we will update this information in the coming months as impacts become clearer or change.

We have been active in assisting our residential and business customers, and promoting awareness of the types of assistance available during this time of unprecedented uncertainty. As health and economic impacts have become clearer, the regulatory framework and expectations for assisting customers has also been evolving. Pre-existing consumer protections in the form of the Commission's Payment Difficulties Framework and the AER's Customer Hardship Guidelines have been added to by the AER's Statement of Expectations, which is due to be revised shortly. In Victoria, the Commission has hosted roundtable discussions on the sector's response to COVID impacts, which, like the AER, is now supplemented with periodic data submissions from retailers and published monitoring reports. The Commission has also recently released draft decisions for further interventions including tariff checks and support for relief

[5] https://www.esc.vic.gov.au/electricity-and-gas/inquiries-studies-and-reviews/electricity-and-gas-retail-markets-review-implementation-2018/assessing-energy-retail-markets-competitiveness-and-efficiency-2019

applications.[6] Ongoing changes to direct government income support will also impact on customers' ability to pay bills and we will continue to engage with the Commission in terms of how this should be reflected in its VDO determinations.

A significant and known policy change implemented recently relates to the AER's rule change proposal for network businesses to defer charges for retailers. As the Commission is aware, the AEMC has ruled that larger retailers will be excluded from this arrangement. The expectation appears to be that these retailers have higher levels of profitability and ability to absorb increasing debt, simply because of their size and ownership. Further policy objectives appear to include tilting the playing field in favour of smaller retailers. As far as we are aware, this decision has not been based on an analysis of retailer vulnerability. As such, we do not consider this to be a fair outcome for affected retailers and is also one that puts at risk the ability of all retailers to provide uniform assistance for affected customers. The Commission will need to consider this issue in terms of the efficient costs being incurred by, and cashflow impacts on, different classes of retailers.

On cost impacts more generally, the Commission's issues paper refers to the need to present a balanced case where cost reductions are identified alongside cost increases. We support this view and the Commission's reference to reductions in network and wholesale costs are critical examples given these items make up around 70 to 80 per cent of customer bills. Lockdowns associated with COVID-19 have allowed our business to avoid material costs, particularly direct travel costs and lost time in moving between EnergyAustralia sites as staff and stakeholder interactions are now done remotely.

Further comments by the Consumer Action Law Centre (CALC) at the Commission's recent public forum[7] suggest that cost increases associated with meeting regulatory obligations may have been incurred anyway as part of systems upgrades and maintenance. Furthermore, while such changes may incur costs, they should save customers money in the medium to long term. EnergyAustralia's business units operate in competitive markets and we have been aggressively pursuing cost reductions over a number of years in order to deliver lower prices for our existing and prospective customers. These actions are and will be reflected in observed cost data as collected by agencies such as the ACCC and the Commission.

The issue highlighted by CALC is that we frequently take issue with compliance costs associated with regulatory interventions where these are imposed without a clear articulation of net benefits. We do this on behalf of customers as these costs are incurred by all retailers and passed on in a competitive setting. CALC's comment may hold true in limited cases however it demonstrates a lack of appreciation for the breadth and number of changes required to billing, marketing, compliance, product design and other retailer functions that have been required, particularly in Victoria, in the last several years. A large proportion of these costs are associated with labour in processing changes through existing systems rather than upgrades. Our business as usual functions include project teams who assess the impacts of regulatory change, and their workload has expanded considerably. These costs are typically not tracked separately and as a result they may be difficult to validate on an ex ante basis. Activities like data reporting to regulators on

[6] https://www.esc.vic.gov.au/electricity-and-gas/inquiries-studies-and-reviews/supporting-energy-customers-through-coronavirus-pandemic-2020

[7] https://youtu.be/uPVxh-pSTSs?t=2207

our retail functions (which is now at unprecedented highs) also results in large opportunity costs for our staff, for example, in using this time to produce insights that aid product design, reduce costs or improve service delivery.

The next VDO determination should run for 6 months

We consider that uncertainties created by COVID-19 justify a shorter determination period. Furthermore, alignment of the VDO determination to changes in network pricing is also likely to reflect a fairer outcome for customers in ensuring they pay for the efficient cost of electricity. While retailers are always under pressure to deliver price reductions, they now face additional regulatory risk from penalties under the Prohibiting Energy Market Misconduct Act, in instances where it may be judged that prices and costs materially diverge. We would seek to avoid this risk by having all price changes aligned to approved AER network tariffs.

We do have some concerns about potential disruption to our standing offer customers due to multiple changes in the VDO over a short period of time. While still uncertain, it appears that network and wholesale costs are falling so such price changes may be welcome.

Alternative approaches would involve the Commission taking on some risk on behalf of consumers about likely network price changes from 1 July 2021. In any market setting, this risk would be reflected in some sort of premium, however we do not expect the Commission to allow for this under the VDO framework. Our recent experience with regulators accommodating network price changes in retail determinations is negative, specifically in how the AER estimated QLD and SA tariffs in the latest Default Market Offer determination. As such, we have low confidence in the Commission’s ability to accurately predict changes for Victoria, particularly as it is not a party to network tariff approvals.

Retail operating costs and risks warrant renewed, detailed analysis

As raised by CALC at the Commission’s recent public forum, we have some concerns that the Commission is basing its benchmark from prior regulatory decisions without detailed consideration of how circumstances have changed over time, particularly in Victoria. The nature of retail service provision has changed to become more considerate of customer hardship, information disclosures, contract protections and ‘fairness’ in general. Some of these changes reflect our own catering for known customer preferences, identified in our own research and in a competitive market setting, as well as regulatory interventions undertaken in the name of expected customer preferences.

We note the Commission has adjusted prior benchmarks for discrete items in its recent determinations but there is likely justification for a more fulsome re-examination of the underlying benchmarks. We expect the Commission may have sufficient capacity to do this with its most recent data request, or could do so for a later VDO determination once data for 2019-20 are available, and it has allowed more lead time than in the current consultation process.

A re-examination of retailer operations and costs should also be accompanied by a consideration of risk, particularly now retailers are taking on (at least a short-term) responsibility in protecting upstream assets from COVID-19 impacts. Further expectations may be placed on retailers in terms of shepherding in cost reflective tariffs and in accommodating new services and service providers associated with distributed energy resources. This type of product innovation is intended to lower overall system costs and should deliver eventual price reductions to customers, however may involve retailers taking on some risk in the transition on behalf of the value chain.

Metering costs and network losses require some further justification

As we have raised previously, we consider the Commission's estimates of metering and loss factors understate the efficient costs of servicing a small but material portion of customers.

On loss factors, the Commission noted that necessary information was not publicly available (e.g. Market Settlement and Transfer Solutions data) to accommodate a more accurate calculation, and that its approach should reflect the losses for "the vast majority of VDO customers".[8] If the Commission considers data are not available to undertake an accurate calculation of which loss factors are more relevant, it should explain how it has decided that the lower loss factors published by AEMO reflect efficient costs, particularly for those customers residing in AusNet's and Powercor's networks. Alternatively, a simple average of the relevant loss factors may be appropriate.

The Commission stated that our proposed approach to setting metering costs, as a customer-weighted average of the costs of different meter types, would overstate the costs for VDO customers.[9] Again it considered it did not have Market Settlement and Transfer data to determine these weights, and also that the impact is immaterial, for example, less than one per cent of a typical bill.

While both items may appear immaterial in isolation, we encourage the Commission to reconsider their materiality against the net margins that retailers are likely to be earning as a percent of a total bill.

Regarding our proposed approach to metering costs, the data presented in our earlier submission was taken from distribution network tariff models published by the AER. The Commission's reference to the need for actual customer data, and discussing costs for "VDO customers", suggests it is only seeking to estimate costs for customers that are currently on the VDO. If this is so, it should consider whether it has also sought to estimate costs only for these customers in other elements of the cost stack. For example, standing offer customers may have particular load characteristics that justify separate wholesale cost estimation. These customers are also mostly serviced by larger retailers, which could have higher or lower costs depending on the cost item in question. We consider it would be more appropriate to estimate an efficient cost to supply all mass market customers using averages, or weighted averages where customer proportions are known. As illustrated above, accurately determining costs only for those customers currently on standing offers, which the Commission considers it has done for the

[8] Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision*, 18 November 2019, p. 30.
[9] ibid., p. 33.

majority, requires information the Commission does not have. Accommodating prospective and not just current VDO customers may also be appropriate now as the VDO is being marketed as "Victoria's fair electricity price"[10], and retailers are now required to invite customers to contact them regarding the VDO on all electricity bills.[11]

The 2020 estimate of the SRES should be subject to a true-up

We support the truing up of the small-scale technology percentage for 2020 and encourage the Commission to consult with the Clean Energy Regulator on developing a best estimate for 2021. We note that as the Commission appears likely to move from calendar to financial year VDO determinations the need to rely on estimates and corrections ex post will eventually be avoided in the future.

Long term supply agreements must be recognised in determining the efficient costs of complying with the LRET

The continuation of a market-based approach, as LGC prices continue to decline, reflects a regulatory risk for our business and would eventually affect the value we ascribe to long-term contracts. This risk is heightened as the VDO does not allow for 'headroom' above efficient costs, which might otherwise allow for a greater margin of error in how the Commission's sets maximum prices.

EnergyAustralia and other retailers underwrote renewable investments and so gave life to the LRET. Such positive responses to government policy will be required again in the near future. The under-compensation of compliance costs associated with a key energy and environmental policy is a real concern for our owners. Significant investment will be required to replace large amounts of retiring thermal generation and to manage the influx of variable generation, including behind the meter generation and demand response. Ultimately customers will wear the cost if we and other companies are discouraged from making further investments in the energy transition.

Overall, we consider that it would be appropriate to determine the industry-wide, efficient, compliance costs associated with the LRET on the basis of forward-looking costs for retailers as a whole. Such an approach would accommodate the expected costs for those retailers who have purchased LGCs under long-term contracts, as well as forward contract prices for retailers who have not.

Overview of the LRET

The purpose of the LRET is to encourage investment in renewable power stations to achieve 33 GWh of additional renewable electricity generation by 2020. On the supply side, certificates are created for each megawatt hour of renewable energy generated or displaced. On the demand side, liable entities (mainly electricity retailers) buy certificates to meet their obligations under the Renewable Energy Target.

[10] https://www.esc.vic.gov.au/media-centre/have-your-say-proposed-changes-victorias-fair-electricity-price
[11] Essential Services Commission, *Ensuring energy contracts are clear and fair - Final decision*, 28 February 2020, p. 68.

Long-term power purchase agreements (PPA) are an integral feature of the LRET. In order to achieve financial close, renewables developers (up until very recently) required long-term revenue certainty from the sale of their output to liable parties. As the main liable parties, large retailers were thus expected to underwrite renewables investment through long-term PPAs, thereby giving effect to government policy.

If liable entities had not signed long-term PPAs but instead waited to procure all their LGCs from the market, or pay the penalty, renewables projects would not have been underwritten and the LRET would have failed as a policy, with higher costs for consumers.

Are PPAs sunk costs?

The argument put in recent regulatory decisions is that while prior decisions to enter into PPAs may have been prudent at the time, the market for certificates has since changed and retailers would therefore now be seeking cheaper LGCs from the market. The Commission's recent final decision stated:

> While a retailer may enter into long-term PPAs, in a competitive market it would not pass through PPA costs that do not reflect market prices. To pass through higher costs than the market value of those certificates, as suggested in several submissions, would put those retailers at a competitive disadvantage.[12]

This is a theoretical position that is not supported by evidence. For example, if EnergyAustralia and other large retailers were not able to recover these costs from the market, we would have already observed the value of PPAs being written down as a result of falling LGC prices.

The majority of certificates surrendered annually come from vertically integrated retailers with significant PPA backing. These retailers make up 80 to 90 percent of the market. While it is true that smaller retailers or new entrants are able to meet their LRET liabilities from LGCs procured in the market, their cost structures do not dictate pricing or what is otherwise recoverable for the market as a whole. In terms of what costs are likely to be supported by the competitive market, the Commission might consider, for example, the likely costs, prices and growing market shares of Alinta, Red/ Lumo and Momentum.[13]

Consistency in the treatment of energy costs

The ESC and AER have indicated that using historical costs for LGCs and forward pricing for energy contracts is inconsistent on a conceptual basis.

> …we do not base the wholesale electricity cost component of the VDO on a weighted average of the electricity component of long-term power purchase agreements. To take a different approach to estimating the cost of large-scale renewable certificates would also introduce a level of inconsistency in approaches.[14]

The Commission should explain the nature of inconsistency and its significance in measuring different items along the cost stack.

[12] Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision*, 18 November 2019, p. 37.
[13] AEMC, *2020 Retail energy competition review - Final report*, 30 June 2020, pp. 29-31.
[14] Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision*, 18 November 2019, p. 37.

The approach adopted by regulators in developing a benchmark contract portfolio for energy purchases reflects observed retailer behaviour. Not all retailers follow the exact approach, but using cumulative book build of forward contracts over 1 to 2 years is recognised as a close approximation of actual practice across all retailers. In contrast, neither the AER nor the Commission appear to have validated the market approach to procuring LGCs with any systematic investigation of retailer behaviour. This lack of empirical evidence base reflects an inconsistency in approach. This inconsistency is more important than maintaining any constant theoretical construct, particularly as retailers are undercompensated for actual costs as a result.

In isolation, the market-based approach is also flawed on a conceptual level. For any certificates to be generated in the first place, and for the "market" to exist, retailers had to underwrite PPAs and could not rely on procuring LGCs from the market. Even ignoring this starting point, if all retailers were to abandon surrendering their 'uncompetitive' LGCs from PPAs, there would be an insufficient volume of LGCs in the market for retailers to satisfy their LRET targets. Demand would outstrip supply and LGC prices would trade at their maximum value, with retailers paying penalty shortfalls and customers paying more than they do now. Further to this circularity, the reason why the traded value of certificates is now falling is because enough long-term contracts were signed in order to meet the 33GWh renewable target.

Finally, in terms of maintaining consistency, it would be technically correct for the Commission to recognise the volumes of energy generated from PPAs in the calculation of wholesale energy costs. However, these volumes are insignificant from a portfolio perspective. The energy procured from renewables PPAs is not firm and wind/ solar output has shaping profiles that are not particularly valuable. By contrast, the costs of LGC arising from PPAs contribute a significant proportion of LRET costs for many retailers. Thus, different approaches to estimation are justified.

What does the market value of LGCs actually represent?

As the bulk of LGCs surrendered come from long term agreements, the LGC "market" is effectively a construct in which residual certificates are traded. The 2020 LRET liability for all tier one and two retailers is approximately 28 million certificates, while the market trades approximately 12 million certificates annually.[15] Note these trades are not unique certificates, for example, they reflect speculative trade of the same certificate between financial intermediaries and liable entities, hence the number of LGCs surrendered from these trades will be much less.

It is incorrect to infer the "market value" of certificates from these trades. As above, the majority of LGCs in existence reflect the value assigned to them at the time PPAs were reached. There is no inherent value in the certificates that are traded, nor is there ongoing demand as occurs for other energy contracts such that prices would fluctuate over time according to typical demand and supply changes. Once the LRET target is met (and it is approaching this point) the value of certificates will trade close to zero as supply significantly exceeds demand.

[15] This is sourced from broker data e.g. TFS. The 12 million does not reconcile to data published by the Clean Energy Regulator, which sums up all certificates (spot and all forward contracts) traded, rather than just spot and current calendar year contracts.

Estimating costs for the efficient retailer/ developing an industry wide approach

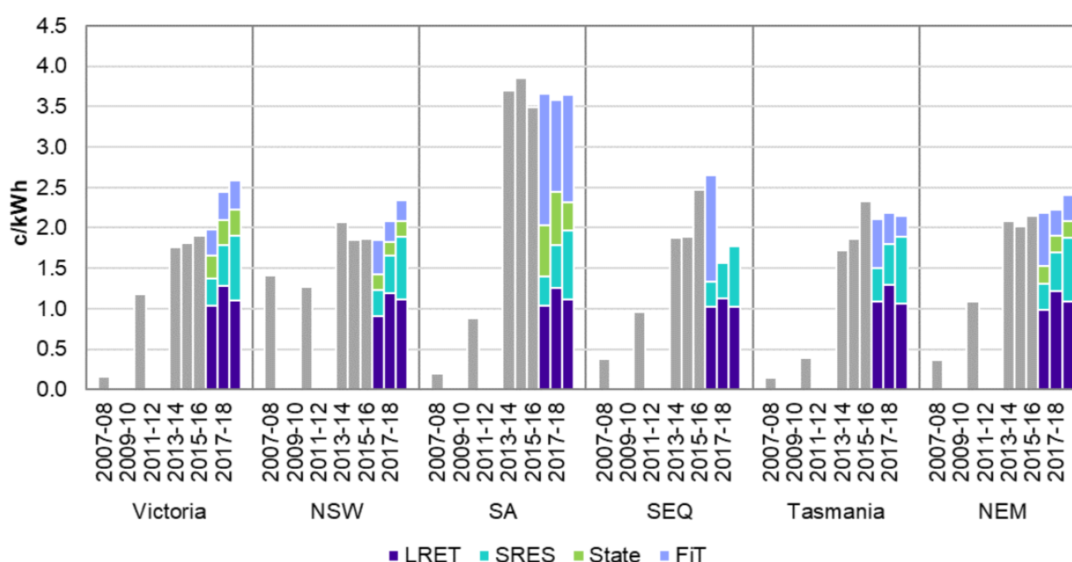
The Commission must determine a set of numbers that reflect the efficient cost of electricity for mass market customers. The legal framework set out in the Order does not provide guidance on whether or how to construct a notional retailer.

For LRET liabilities, the Commission is effectively adopting an approach that emulates small retailers or new entrants. It may be that this is consistent or best reflective of the Order's requirements. If so, the Commission should be forthcoming on what this means for other items in the cost stack, for example, wholesale costs, retail operating costs etc.

Validation of the market approach with retailer cost data.

The ACCC's reporting indicates that LRET liability costs for retailers on average has been stable over the years 2016-17 to 2018-19 at around $10 to $12/MWh. Prior years are not disaggregated although the total value of environmental costs for 2013-14 to 2015-16 suggest LRET costs might be unchanged or in line with a slight increasing trend. Note that LGC market prices were $30 in 2014 and peaked above $80 in 2016 and 2017.[16] It seems unlikely that the ACCC's data would align with a more than doubling of LGC prices under the market approach, even with lags associated with a progressive purchasing strategy. For the same reason, successive years of reported retailer costs are unlikely to reflect recent and expected falls in the market price of LGCs.

Figure 2.32: Average effective price for environmental costs per residential customer by NEM regions, 2007–08 to 2018–19, real $2018–19



Source: ACCC, November 2019, p. 63.

[16] https://www.energycouncil.com.au/analysis/traders-taxes-and-renewable-energy-certificates/

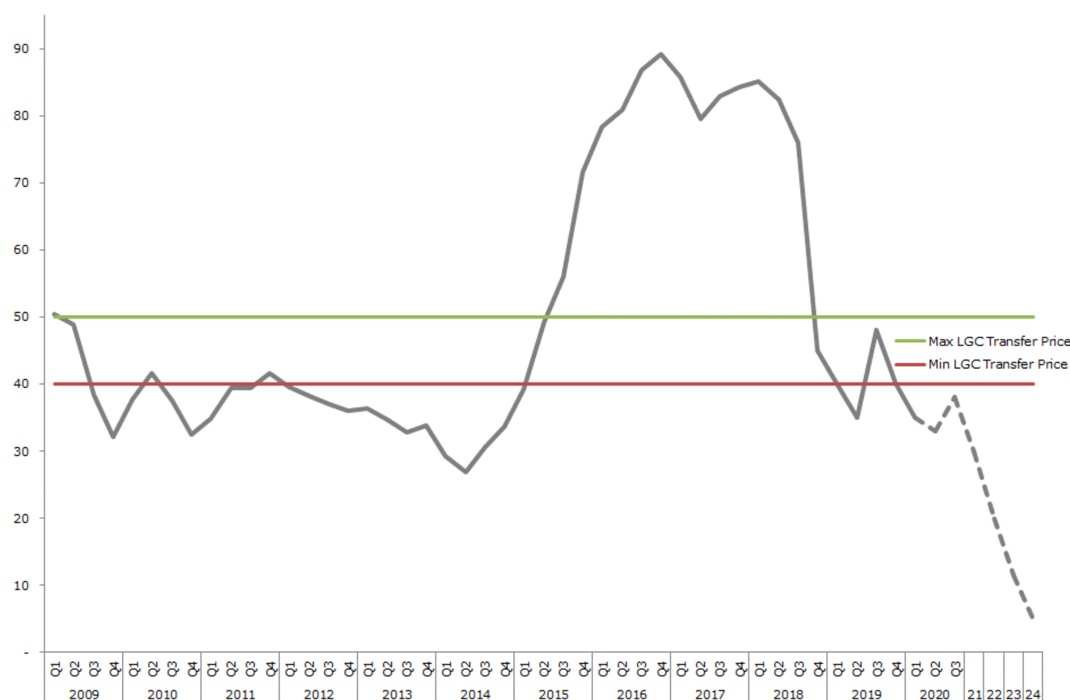
Note the ACCC's data set may reflect the dominance of tier one and other large retailer costs. How this data (and indeed all actual cost data) should be used depends on whether efficient costs should be weighted towards market share, reflect an unweighted average of retailers, or reflect new entrants.

Our alternative approach

We presented our approach for determining weighted average LGC price last year in response to the Commission's draft VDO determination. This relies on public data on PPAs to determine the extent to which large retailers are exposed to long-run historic costs and uses the market-based approach to determine the LGC price for the remainder. It reflects an average LGC price for the entire Victorian retail market.

From public announcements, collated by paid advisory services, we are able to determine the total volume of PPA offtakes for larger retailers. From this, assumptions need to be made to allocate these LGCs to Victorian mass market load. In the absence of any reason to treat customer segments or jurisdictions differently, we consider pro-rating certificates in line with energy sales is appropriate.

Our expectation is that retailers may have paid between $40 to $50 a certificate under PPAs struck in the last 10 years. This roughly reflects the average traded certificate value over this time.



Source: EnergyAustralia

Certificate values for residual load and for smaller retailers can be drawn from the Commission’s market-based approach.

The above certificate values and LGC sources for each retailer can then be combined to produce a volume weighted LGC price, as per the calculation below.

	DEMAND					SUPPLY		
	Vic Residential Customers	Vic MM Approx Operational Demand	Vic MM LGC Obligation (2020 19.96%)	LGC Demand National	Vic MM as a proportion of LGC portfolio	Retailers' National LGC PPA Offtake	Retailers' LGC Offtake Applied to Vic	LGC Offtake VWP
	A	B	C	D	E	F		
Source/Formula	ESC	= A * 4.2MWh	= B * 19.96% RPP	Estimate	= C/D	Estimate	=MIN(C, E * F)	Estimate
	K	GWh	K LGC	K LGC	%	K LGC	K LGC	$/LGC
AGL	551	2,314	462	6,000	8%	5,200	400	*$48.00*
ORIGIN	457	1,917	383	7,000	5%	6,000	328	*$45.00*
EA	455	1,913	382	3,500	11%	2,400	262	*$50.00*
SNOWY (RED)	404	1,697	339	873	39%	2,152	339	$50.00
ENGIE (SIMPLY)	240	1,008	201	408	49%	783	201	$50.00
ALINTA	89	375	75	560	13%	1,359	75	$50.00
MOMENTUM (HYDRO TAS)	79	333	67	1203	6%	762	42	$50.00
OTHER SMALL RETAILERS	244	1,026	205			1,000		$50.00
	2,520	10,584	**2,113**			**19,656**	**1,647**	**$47.94**

Source: EnergyAustralia

The assumptions and estimates involved in this calculation can be validated by examining historic cost data the Commission is collecting for each retailer, for market averages published by the ACCC, or by seeking a sample of financial information from representative retailers.