19 April 2024

Ms Kate Symons
Chair
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne Victoria 3000

Email: VDO@esc.vic.gov.au

Dear Ms Symons,

RE: 2024-25 Victorian Default Offer – Draft Decision

Origin Energy (Origin) appreciates the opportunity to provide a submission in response to the Essential Services Commission's (ESC) Draft Decision for the 2024-25 Victorian Default Offer (VDO).

Origin strongly supports the ESC's decision to apply a consistent method to calculate the VDO for 2024-25. A stable regulatory framework contributes to a well-functioning retail market and provides retailers with certainty so that they can appropriately manage their financial risks.

In terms of the wholesale cost allowance, we support the ESC continuing with its current approach. However, we believe it would be good regulatory practise for the ESC to test whether its modelled outcomes fall within actual price outcomes and therefore allow a prudent retailer to recover their efficient costs.

Origin has several concerns with the operation of Victorian Energy Upgrade (VEU) program. Because of an emerging shortfall in certificate creation, retailers face a real risk of penalty cap payments. We consider the ESC should recognise the structural deficiencies in this scheme and ensure that retailers are fully compensated for the prudent purchase of certificates.

Additional commentary on these and other matters contained in the ESC's draft decision are provided below.

Wholesale Energy Costs

We continue to support the market-based approach to forecast the wholesale energy cost, including using a combination of ASX Energy cap and swap trade data to determine a retailer's hedging costs. We agree that ASX Energy contracts remain the most traded contracts in the futures market and generally provide for the most accurate representation of a typical retailers' efficient costs.

Under the current approach, the ESC bases the WEC on the 50th percentile of estimated outcomes with retailers compensated for the higher risk associated with choosing the median simulated year with a volatility allowance. In applying the 50th percentile, the ESC assumes that there will be decisions where the estimated WEC will exceed the actual WEC and times when it will fall short. Over the long run, and with the inclusion of the volatility allowance, retailers will be made whole. However, this only holds if the actual WEC falls within the distribution of modelled WECs.

We consider it would represent good regulatory practice for the ESC to test whether an actual WEC using its assumed hedging portfolio and actual load and price data would fall within its distribution of modelled outcomes. If the actual WEC falls outside of the modelled distribution over multiple years, we believe this would demonstrate a need for the ESC to consider increasing its choice of selected percentile.

Retail Operating Margin

As part of its 2023-24 final decision, the ESC indicated it would engage with stakeholders to further consider alternative methods to set the retail margin. We support the ESC considering a more objective framework including setting out the preconditions that would trigger any change to the margin, and strongly support for this work to be done in consultation with stakeholders.

Retail Costs

We support continuation of the current benchmarking approach for retail operating costs. The ESC's costs should continue to be consistent with the costs reported to the ACCC by retailers.

Network Costs

We support the ESC using AER approved network prices for 2024-25. If network prices are not available at the time the ESC makes its final decision that the ESC should utilise the 2024-25 network tariffs submitted by the Victorian networks for approval to the AER.

Victorian Energy Upgrades program

The VEU scheme is currently experiencing unforeseen supply side disruption. These issues were not anticipated when the ESC developed its cost-recovery method and as a result retailers will potentially be exposed to financial losses unless the ESC modifies its approach.

These issues stem from the phasing out of residential lighting and the removal of refrigerated cabinets from the scheme. Historically these accounted for over 45 per cent of certificate creations. However, they have not been replaced by new activities in the VEU program. The impact of their removal has led to a significant reduction in certificate creations. For example, as of 14 April 2024, only 1.2 million certificates had been created against the 2024 annual target of 7.1 million certificates. This is in addition to a shortfall in 2023 when 4.7 million certificates were created against a target of 6.9 million certificates.[1]

The impact of this shortfall has so far been offset by a carryover of an historic surplus of certificates. However, given the emerging gap between creation and targets, this surplus is likely to converge to zero. It is our view that in the absence of existing activities generating higher certificate numbers or the introduction of new activities, retailers will not be able to acquire sufficient certificates to meet their obligations and therefore face penalty cap prices.

To avoid retailers being exposed to financial risk outside of their control, we request that the ESC recognise the deficiencies with the VEEC scheme and investigate ways to ensure that retailers are not financially disadvantaged in meeting their obligations.

If you wish to discuss any aspect of this submission further, please contact Sean Greenup ([redacted]).

Yours Sincerely,

[redacted]

Steve Reid
General Manager, Regulatory Policy

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[1] Victorian energy efficiency certificates | Essential Services Commission, accessed 15 April 2024.