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Victorian Default Offer 2020 price determination
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne, Victoria 3000

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Victorian Default Offer to apply from 1 January 2020 – Draft Decision

Alinta Energy welcomes the opportunity to make a submission regarding the Essential Services Commission's Draft Decision the *Victorian Default Offer to apply from 1 January 2020 – Draft Decision*.

Alinta Energy is an active investor in energy markets across Australia with an owned and contracted generation portfolio of nearly 3,000MW, and in excess of 1.2 million electricity and gas customers.

The Order-in-Council published by the Victorian Government on 30 May 2019 (the Order)[1] extends the VDO to include non-flat tariffs and requires the Commission to set a maximum annual bill for customers on these tariffs. In setting the maximum annual bill Alinta Energy believes that the Commission should be guided by the objective of the VDO as defined in the Order:

> *The objective of the Victorian default offer is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market*

That is, the VDO is to be:

- Simple,
- trusted, and
- reasonably priced.

In Alinta Energy's view the Commission has placed greater emphasis on the VDO being "reasonably priced" at the expense of being "simple" and "trusted" This skewed approach to the VDO objective results in an unnecessarily complex Draft Decision, with non-flat tariff structures that are not reflective of network costs, uncommon and demand-based tariffs that are not defined, as well as wholesale costs that are not representative of the current energy market. Whilst these outcomes may lead to a lower cost VDO, they are not cost-reflective and, on that basis, not reasonably priced.

[1] Order-in Council available at http://www.gazette.vic.gov.au/gazette/Gazettes2019/GG2019S208.pdf.

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In addition to the impact of these issues on consumer outcomes relating to expectations, confidence and understanding of how the VDO is priced and operates, i.e. trust, Alinta Energy is also concerned with the onus placed on retailers to manage these new and unaccounted for risk exposures with their retail offers.

Alinta Energy acknowledges the challenge of delivering a balanced VDO that meets all three components of the VDO objective, particularly as the VDO is dependent on inputs that are yet to be finalised for 2020 and requires subjective decision-making when determining reasonable costs. To that end, we recommend the Commission adopt the following amendments in the VDO final decision;

1. Incorporate final Victorian network tariffs, due for release on 9 November 2019,
2. Include only the non-flat tariffs described in the Order as part of the VDO maximum annual bill,
3. Incorporate applicable network costs to non-flat tariffs,
4. Use representative wholesale energy market conditions, limited to on the previous two financial years, and
5. Incorporate retail operating costs that reflect the costs of regulatory reforms.

Our further detailed comments on the Draft Decision are set out below. Should you require any additional information or wish to discuss any aspect of our submission please contact Ante Klisanin, Retail Regulation Manager on (03) 8533 7344 or via email: ante.klisanin@alintaenergy.com.au.

Yours sincerely

Shaun Ruddy
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Network Costs

Alinta Energy supports the Commission's stated approach for network costs to be a direct pass through to customers. However, using the flat tariff VDO in each distribution area to set the maximum bill amount for non-flat tariffs is inconsistent with a network cost pass-through approach, and its impact worsened by the extent to which non-flat tariffs diverge from flat tariffs.

For example, Table 1 shows the difference in network costs between flat and non-flat structures, as per the United Energy Pricing Proposal for 2020.[2]

Table 1

Network Tariff	Tariff Code	Fixed Charges c/day	Peak or Anytime c/kWh	Off-peak c/kWh
Flat	LVS1R	7.85	9.49	-
Peak & Off peak	LVS2R	15.93	14.77	2.29
Variance		**203%**	**156%**	**N/A**

Peak charges are 50% higher under the non-flat tariff, whilst the fixed daily charge of the non-flat tariff is more than double the flat-tariff charge. The effect of these differences is that, dependent upon how each non-flat tariff is structured, the maximum annual bill will either under-recover or over-recover network costs, but it is never likely to be an accurate network cost pass through.

Alinta Energy understands that the Draft Decision represents a simple method to deal with non-flat tariffs, and can be easily applied across various tariff structures, but it does not represent a cost-based approach, given the variation in flat and non-flat network tariffs

To minimise the potential impact of this approach, Alinta Energy recommends the Commission selects the 'most common' non-flat tariff in each distribution network and calculates the maximum annual bill using the network costs of that tariff. This will ensure that, at least the most common non-flat tariff will have an accurate network tariff cost pass through, consistent with the flat tariff approach, and as supported by all stakeholders.

The Draft Decision also uses proposed network tariffs published by distributors in October 2019 for the 2020 calendar year. As the Commission has recognised, for the VDO to be a cost-based determination, the VDO Final Decision must be based on the final 2020 network tariffs due for release on 9 November 2019.

[2] https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/pricing-proposals-tariffs/ausnet-services-annual-pricing-2020/propos

VDO compliant maximum annual bill

Alinta Energy commends the Commission for taking a simple, trusted and consistent approach to base the maximum annual bill on a set consumption level of 4,000 kWh per annum. Given the complexity associated with determining a maximum annual bill for a non-flat tariff we welcome an outcome that allows customers to have a consistent approach to that of flat tariffs.

Further complexity is created by the existence of uncommon and demand-based tariff structures. Alinta Energy notes that whilst the Order provided guidance on how to set a maximum annual bill for five different non-flat tariff structures, in the form of usage profiles, no guidance was provided for uncommon and demand-based tariff structures.

To accommodate these tariff structures, the Draft Decision proposes that retailers be required to submit usage profiles (including demand components) to the Commission for approval to calculate the applicable maximum annual bill.

Alinta Energy does not support this proposal and recommends that until further guidance is provided by the Commission or the Victorian Government, these types of non-flat tariff structures should be excluded from the maximum annual bill process. Alinta Energy's concern with retailers determining usage profiles based on their customers usage data is that;

I. Usage profiles submitted by retailers will differ based on the respective consumption patterns of their customers, and lead to differing maximum annual bills amounts across retailers for the same tariff type. This would remove the ability to directly compare offers.
II. Where a retailer has a small number of customers on an uncommon or demand-based tariff, the customer usage data is likely to be unrepresentative of the overall market, leading to distorted pricing outcomes.
III. Retailers could not commence pricing uncommon or demand-based tariffs until final network costs had been approved (9 November 2019) and the Commission had made their final VDO determination (25 November 2019). Given that retailers are required to gazette their standing offer tariffs one month prior to 1 January 2020 (i.e. 1 December 2019) it would be unfeasible to diligently conduct this submission and approval process with the Commission for these tariff structures.

Alinta Energy believes the most appropriate consumer protection for customers on these tariff types in the current circumstances, is to continue to gazette uncommon and demand-based tariffs on 1 December 2019 along with the VDO Final pricing.

Wholesale Energy Costs

During the Commission's public forum held on 8 November 2019, Frontier Economics presented their approach to calculating the VDO Wholesale Energy Costs (WEC). In previous submissions, Alinta Energy recommended the use of segregated MRIM data to accurately represent the profiles and associated costs of small business customers and residential customers, as the use of aggregated data can significantly impact the WEC. We again commend the Commission for updating the previous VDO determination to use segregated MRIM data for the 2016/17 and 2017/18 financial years.

The Draft Decision now incorporates three financial years (2016/17 to 2018/19) of MRIM usage profile data mapped against the historical spot prices for the applicable period. Alinta Energy views the use of 2016/17 financial year data to be an unreliable basis for forecasting future prices against usage profiles due to the closure announcement and actual closure of the Hazelwood Power Plant in that financial year. Price volatility has since increased significantly due to the decrease in supply and an increase in unreliable energy sources. We further note that usage profiles will continue to change due to the increasing reliance on solar PV. To ensure usage profiles are relevant to the forthcoming VDO period, all future VDO determinations should be limited to the preceding two financial years.

We note that at the forum Frontier Economics confirmed that the use of either two or three years of data was simply a 'Judgement call" and was open to considering why the last two years would be more representative of energy market conditions.

Major changes to retail operating costs since May 2019.

As raised in previous submissions, the Commission continues to exclude the reasonable operating and implementation costs associated with regulatory reform.

As part of the Commission's advice to the Victorian Government on 3 May 2019, the *Victorian Default Offer to apply from 1 July 2019* included an allowance of approximately $3 per customer for the implementation and maintenance of the Payment Difficulty Framework (PDF). As noted in the 1 July VDO advice;

> '*Given that the benchmark data we used is unlikely to fully include these net costs, we proposed in our draft advice to include an allowance in the VDO for PDF related compliance costs at the upper end of the range adjusted for inflation.*'

Alinta Energy welcomes the Commission's consideration of PDF regulatory compliance costs but notes that a large number of significant regulatory reforms, specific to the Victorian energy market, were implemented on 1 July 2019 which should also be included in the 2020 VDO. Table 2 below summarises the regulatory reforms implemented on 1 July 2019 and the number of business days retailers were allowed for implementation.

Table 2

Reform	Final Decision	No. of business days from final decision to implementation
Best offer on bill	30/10/2018	160
Clear Advice on all offers made	30/10/2018	160
GST inclusive pricing	30/10/2018	160
Advanced notification of price changes	30/10/2018	160
Customer provided meter reads	21/03/2019	65
Helping customers engage confidently in the retail energy market	21/03/2019	65
Technical final decision on Energy Fact Sheets	9/05/2019	35
Victorian Default Offer - Price determination	30/05/2019	20
Victorian Default Offer as a reference price	30/05/2019	20
Victorian Default Offer - Corrigendum to VDO	31/05/2019	19
Victorian Default Offer - consequential changes to the ERC	13/06/2019	11

We note that retailers have provided the Commission costings associated with these reforms and request that these costs are incorporated into the final VDO decision.

One item not included in the costings provided to the Commission are the compliance costs associated with the Retailer Reliability Obligation (RRO).

As part of the RRO consultation process, the Energy Security Board released a regulatory impact statement on 19 December 2018 which determined that compliance costs for the RRO associated with market customers and large end users would be in the range of $176 million over the next 10 years[3], These compliance costs include both operational compliance costs and physically backed contracts. Alinta Energy also requests that the Commission incorporates these costs as part of their Final Decision.

[3] Energy Security Board, Retailer Reliability Obligation Decision Regulation Impact Statement, 19 December 2018, p.44