AGL Energy Limited
T 02 9921 2999
agl.com.au
ABN: 74 115 061 375

Level 24, 200 George St
Sydney NSW 2000
Locked Bag 14120 MCMC
Melbourne VIC 8001

Essential Services Commission Victoria

Level 8, 570 Bourke street

Melbourne VIC 3000

Online via: www.engage.vic.gov.au

19 April 2024

2024-25 Victorian Default Offer Draft Determination

AGL welcomes this opportunity to comment on the Essential Services Commission's (ESC) Victorian Default Offer 2024-25 Draft Decision (Draft Decision), as published on 19 March 2024.

AGL operates nationally across the energy supply chain and delivers 4.3 million gas, electricity, and telecommunications services to our residential, small and large business, and wholesale customers across Australia. We also operate Australia's largest electricity generation portfolio, with a generation capacity of over 11,000 MW, accounting for approximately 20% of the total generation in the National Electricity Market.

As set out in the draft decision, the ESC intends to use the same approach for calculating the 2024-25 Victorian Default Offer (VDO) prices as was used for the 2023-24 VDO final determination.

In the interests of continued regulatory certainty and transparency, AGL supports the ESC keeping the VDO methodology unchanged subject to necessary refinements when material factors result in the methodology failing to reflect cost changes.

As set out in our attached response, we highlight two issues for consideration. First, it is generally accepted that material changes to improve the VEU program have created a structural change in the supply demand balance and certificate cost. Further reform and significant time will be required to enable scale of up lower cost supply. The ESC should give greater weight to recent VEEC prices in estimating VEU retailer costs. Secondly, we reiterate our concern with the VDO application of the lower bound retailer operating margin benchmark of 5.3 per cent.

The Draft Determination demonstrates a shift in the underlying cost pressures on customer bills from wholesale to network costs. Network costs are the largest component of retail bills. We note the regulatory and economic drivers that are causing the forecast increase in network prices are likely to remain in place beyond this VDO pricing period. There are now significant affordability challenges for future VDO pricing determinations if the network charges continue to grow.

If you have any questions in relation to this submission, please contact Kyle Auret on [redacted].

Yours sincerely,

Ralph Griffiths
General Manager
Policy and Market Regulation

AGL response to VDO Draft Decision

Environmental Costs – Victorian Energy Upgrades Program

We do not consider the 12 Month trade-weighted average spot price for Victorian Energy efficiency certificates (VEECs) is an appropriate methodology to derive the forecast costs of the program in the regulatory pricing period.

Whilst this approach has been broadly appropriate to forecast a retailer's VEU costs in previous pricing determinations, there has been a significant step change in the spot price from July 2023. Prices are now trending above $90. As the ESC is aware, there remains material challenges to reform and scale up the program to facilitate a significant increase in abatement activities that in turn can be translated into improved market liquidity and lower certificate prices. It is likely the VEEC spot price will remain at the elevated price currently observed for the next year.

We consider a shorter historical period of the trade weighted average spot price is a more reasonable forecast of the retailer's VEU program costs for the 2024-25 VDO pricing period. With limited certificate market liquidity and high spot prices, the key avenue for retailers' to acquire certificates will likely be through the spot market during the relevant VEU regulatory periods of calendar year 2024 and 2025. A reasonable forecast cost of these certificates more closely resembles the previous market conditions in the last three months of trading on the spot market.

This approach is also prudent given the market liquidity concerns potentially arising from Q1 2025. In the extreme, the insufficient certificate volumes may expose retailers to the program penalty amount. Whilst it is unclear if this outcome will eventuate, given the current program challenges this remains a real possibility.

We therefore propose the ESC adopt a more cautious pricing methodology that appropriately reflects the ongoing market conditions observed over the previous 3 months of trading that will likely carry through into the VDO pricing period.

Retail Operating Margin

The Draft Decision determined to use the same retail operating margin benchmark of 5.3 per cent the ESC used in the last VDO decision.

As set out in our previous submission, we do not support the application of the lower bound benchmark rate. We consider the upper bound rate is more appropriate given the market risks faced in the Victorian market.

As noted in the draft decision, actual retail margins are lower than envisioned by the ESC when determining the VDO price. The ACCC December 2023 Electricity pricing report show that that the actual retail margins across the market are extremely thin and that VDO calculation may provide false comfort as to whether the VDO is set at a sufficient level to allow retailers to compete below it.

The ESC draft decision observes that the 5.3 per cent benchmark is within the range of accepted returns approaches used by other regulators, however the ACCC report demonstrates that the application of the upper bound of these benchmarks is the more prudent approach.