16 June 2021

EnergyAustralia Pty Ltd
ABN 99 086 014 968

Level 19
Two Melbourne Quarter
697 Collins Street
Docklands Victoria 3008

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

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

Chairperson Kate Symons
Commissioner Sitesh Bhojani
Commissioner Rebecca Billings
Commissioner Simon Corden
Level 8
570 Bourke Street
MELBOURNE VIC 3000

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

Dear Chairperson and Commissioners,

2022 VDO review – PUBLIC VERSION

EnergyAustralia welcomes the opportunity to make this submission to the Commission's 2022 VDO review.

EnergyAustralia is one of Australia's largest energy companies with around 2.3 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. EnergyAustralia owns, contracts, and operates a diversified energy generation portfolio that includes coal, gas, battery storage, demand response, solar, and wind assets. Combined, these assets comprise 4,500MW of generation capacity.

Our general comment is that we encourage the Commission to maintain an openness to continuing to refine and adjust the VDO methodology where appropriate. This is still important even though the Commission is up to its fourth VDO price review. It is important to ensure that the VDO reasonably reflects the efficient costs of Retailers so that Retailers can recover their efficient costs for Standing Offer customers. It is also pertinent that the VDO reference price reflects efficient costs as it has an impact on customer behaviour and competition.

Our submission below is targeted and focusses on a few issues with the Commission's proposed approach for the 2022 VDO determination.

Length of regulatory period

The Commission seeks feedback on the length of the 2022 VDO regulatory period and proposes the options of six months or 18 months. Both options have issues. On the one hand, an 18-month VDO would have greater forecasting uncertainty and a higher risk that efficient costs would diverge from VDO estimates of those costs. On the other hand, combined with VDO changes in 2021, a six-month VDO will mean four price variations in about 18 months (January 2021 – July 2022). Complying with the many direct and flow-on obligations associated with changing the VDO (and varying the prices of Standing Offer customers) would lead to a material increase in costs. Our approximate costs for the 1 September VDO variation will be [**Confidential:**] – more details on these costs are set out at the end of this submission.

To avoid incurring another set of these costs in January 2022, an alternative option would be to extend the current 2021 calendar VDO (as varied) to end June 2022, with an adjustment to wholesale electricity or other costs that are over or under recovered, in the next VDO commencing July 2022. We recognise that this option may not be attractive to the Commission where the VDO is materially changing (and the Commission would likely wish to pass on any material changes ahead of July 2022). However, while wholesale prices have been decreasing in Eastern Australia, it is not certain that the change in the wholesale component for a VDO that is effective for a six-month period from January 2022 would be lower, or that it would lead to a material change in the VDO.–The Commission should balance the materiality of passing any reductions (or increases) to the VDO on 1 January 2021, against the administrative cost of a VDO change on 1 January 2021. As these costs are material and may exacerbate or offset the change in the wholesale component. We also urge the Commission to gather data from other Retailers about the costs related to changing the VDO to assess this issue further.

If no resolution can be found and the January 2022 VDO must proceed with a six-month regulatory period, then we provide the following comments on how the Commission should approach the calculation of that VDO.

Wholesale electricity costs for six-month regulatory period

If the Commission were to adopt a six-month VDO, our main concern is around calculating wholesale electricity costs for that VDO and the need to ensure the appropriate recovery of the higher wholesale electricity costs of H1 2022.

In a typical VDO determination wholesale electricity costs are determined by Frontier (based on ASXEnergy contract prices). Q1 prices and consequently H1 prices are significantly higher than H2 prices – but for the purposes of calculating the VDO they are effectively "averaged" across the year. This means that in practice Retailer's under-recover in H1 but this under-recovery is "balanced out" in the remaining months in H2 when wholesale electricity costs are lower and there is essentially an "over-recovery". The same balancing will occur when the VDO moves to a financial year cycle, but with shifts in timing. i.e. there will be an over-recovery in H2 to balance out the under-recovery in H1 *the following year.*

If the 2022 VDO has a six-month regulatory period from start 2022, this will cover the H1 period with higher wholesale electricity costs. It is highly important that the Commission sets the VDO in a way that enables the recovery of these higher H1 costs. There is a risk that these costs will not be appropriately recovered depending on the period of wholesale electricity costs that are used.

An example of the problem:

- If the Commission uses the wholesale electricity costs for calendar year 2022 for the six-month VDO this means there will be an under-recovery of those costs in *H1 2022*.
- This will not be rectified in H2 2022 (as is typically the case) because H2 2022 will fall under the next VDO determination and will provide the balancing out for *H1 2023* (when the VDO moves to financial year).
- Put simply, the issue arises because there are two "lots" of H1 costs (H1 2022 and H1 2023) to recover, but only one H2 period (H2 2022) to balance/over-recover in.
- In this way, Retailers will under-recover for one lot of H1 costs.

The problem still occurs:

- If the Commission adopts H2 2021 + H1 2022 wholesale electricity costs to determine wholesale electricity costs for H1 2022.
- Retailers will face an under-recovery in *H1 2022* that will not be rectified in either:
    - H2 2022 because that is already balancing out the under-recovery for *H1 2023* (when the VDO moves to financial year), nor
    - H2 2021 because that has already balanced out *H1 2021*.

We consider the above problem is only addressed if the Commission uses:

1. Wholesale electricity costs for H1 2022 only; or
2. Wholesale electricity costs of H2 2021 + H1 2022, *but with H2 calculated as per the whole 2021 calendar year* (averaged over the 2021 calendar year).

We would be pleased to explain this more to the Commission and Frontier.

Marginal Loss Factors

We welcome the Commission's weighted average approach in respect of calculating Distribution Loss Factors and ask the Commission to consider applying the same approach to Marginal Loss Factors (MLF) to improve the accuracy of its MLF adjustments to wholesale electricity costs under the VDO determination. This change would promote fairer and more efficient outcomes by allowing Retailers to appropriately recover wholesale electricity costs for Standing Offer customers.

The Commission states that it does not propose changes to setting its MLF parameter but is open to assessing any views on the matter. The Commission observes there is a narrow range in MLFs across the Ausnet and Powercor zones (regions where EnergyAustralia has higher percentages of customers) and therefore it has maintained a simple average. The assumption seems to be that because the range is narrow then the effect of any discrepancy between the actual MLF for the customer and the average MLF will be limited. We question this logic – differences in MLF can result in material differences for Retailers in recovering costs.

Take for example, the VATS TNI which is 1.0065 and is around 2% above the Commission's current simple average of the MLF (0.9867). Assuming $100/MWh in electricity costs, 2% x $100 x 4MWh (4MWh being the representative residential customer consumption) would be $8 per annum per customer.

In terms of the scale of the issue, we can provide updated numbers on the affected volumes for the Powercor region (our most impacted area with the most customers). Previously we noted that about 75% of the aggregated usage from our Powercor customers are on an MLF that exceeds the simple average (0.9867) used by the Commission.

In view of the above, we ask the Commission to consider a weighted average instead of a simple average approach to calculating the MLFs. We acknowledge that the Commission may not have the usage data to calculate the weighted average approach but that this can likely be obtained from AEMO. We can also provide EnergyAustralia's updated data and calculations to inform this issue on a single Retailer level if that would assist the Commission in deciding whether to investigate the issue more broadly in its Draft Determination and whether it engages with AEMO.

Energy costs for Two Period Time of Use (TOU) VDO prices

The Commission will set a new Two Period TOU VDO price which we support overall. This new specific VDO price will reflect the two different peak/non-peak components of the network tariff; but it will not reflect different energy costs for the peak and non-peak periods. Rather, it will use the energy costs for the flat tariff. We accept that this is the appropriate and most workable option in the short term (for the VDO variation for 1 September 2021 and for the 2022 VDO).

However, we contend that it may be appropriate for the Commission to evolve this approach to reflect a different energy cost component for the peak and non-peak periods in the mid-term (3-5 years). Adopting different energy cost components for the peak and non-peak periods would allow the price signal for TOU customers to apply along the whole VDO cost stack, therefore providing a more effective and stronger price signal to customers. This stronger price signal would promote more efficient outcomes where customers have greater incentive to shift some of their usage to off peak times when the costs of energy are lower.

The scale of this issue is not negligible. There are around 400,000 TOU customers which constitutes about 15% of the total residential and small business electricity customers in Victoria (although Standing Offer customers would be a smaller proportion of this customer group which we estimate to still be around 20,000 customers). A stronger price signal would help to incentivise these customers to shift their usage to non-peak times resulting in more efficient outcomes for the broader electricity market, compared to where TOU customers have a weaker price signal and do not shift their usage.

A stronger price signal is important considering that a significant proportion of TOU customers in some distribution regions have solar PV at their premises. [**Confidential:**

]. For TOU customers with solar PV, shifting their energy usage from peak times to non-peak times where there is solar PV generation provides the additional benefit of "soaking" up their solar PV generation and therefore provides the additional benefit of assisting with emerging minimum demand issues. The price signal may also act in a secondary way of incentivising investment in battery to further reduce customer usage of electricity from the grid during peak time periods.

We also expect that Retailers will reflect different energy costs for peak and non-peak periods in their own TOU pricing for Market Offers, following the introduction of the new Two Period TOU network tariffs in July this year. The Commission should monitor these changes and the VDO should mirror them.

Large-scale Renewable Energy Target (LRET) costs

We disagree with but acknowledge the Commission's approach to LRET costs (to continue to base them on futures market prices for Large-scale Generation Certificates (LGCs) only and not the higher PPA cost). We support the Commission's previous position that it will continue to monitor market prices for LGCs and cross check these prices against Retailer costs of meeting the LRET and if appropriate revisit its approach.

Under-recovery of network costs in 2021 VDO variation

As previously raised, for some Distribution Network Service Providers (DNSPs) which are increasing their final network tariffs from 1 July 2020, there will be an under-recovery where the VDO variation (to pass through this increase) lags and does not occur until later. The previous effective date of 1 August 2021 has now been extended to 1 September 2021 which means a longer time lag than originally anticipated and a greater under-recovery. We strongly urge the Commission to include an adjustment in the 2022 VDO to correct the under-recovery (and accept that any over-recovery from final network tariffs reducing will also be factored in).

From a policy standpoint, it is unclear why the Commission would not adjust the VDO for the under-recovery. As the Commission points out itself, unlike other cost components, network tariff costs are known, certain, and are clearly borne by Retailers. It would be reasonable to expect that an adjustment would occur, in the same way that an adjustment is made for the default and binding renewable power percentages under the current VDO methodology.

In our submission to the VDO variation consultation paper, we estimated that the network cost under-recovery is approximately $5 for each customer *per month*, based on the AER's Tariff Structure Statements (TSS). This was a conservative estimate that likely understates the amount. We consider this to be a material amount particularly when compared with other cost adjustments previously made by the Commission. For example, the $0.21 per customer *per annum* increase in the 2021 VDO to reflect the higher Retailer operating costs associated with introducing five-minute settlement. We will provide revised estimates of the under-recovery when the AER's final network tariffs have been released.

Costs of the 2021 VDO variation

We submit that the Commission should consider including a one-off adjustment to reflect the additional administration costs linked to implementing the VDO variation/additional price variation for Standing Offer customers. In effect, Retailers are wearing the cost of a second price variation in Victoria for the year 2021, after having completed one in January 2021 (and as discussed above, Retailers will incur the cost of another VDO change in January 2022). These costs are due to Victorian Government decisions which are beyond the control of Retailers.

Further, these additional administration costs are material. **[Confidential:**

] We can provide further detailed information on specific costs that are directly attributable to this VDO variation. As above, we also urge the Commission to seek the same cost data from other Retailers not only to support a one-off adjustment in a VDO determination to allow recovery of these costs, but to also consider the costs of requiring another price variation in January 2022 (see Length of regulatory period on page 1).

If you have any questions in relation to this submission, please contact me (Selena.liu@energyaustralia.com.au or 03 8628 1548)

Selena Liu
Regulatory Affairs Lead