16 June 2021

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: Next steps for the Victorian Default Offer – Consultation Paper

Origin Energy (Origin) appreciates the opportunity to provide a submission in response to the Essential Services Commission's (ESC) proposed approach to the 2022 Victorian Default Offer (VDO) as part of the *Next steps for the Victorian Default Offer* consultation.

We are generally supportive of the ESC maintaining a consistent approach to the calculation of the VDO for 2022. Continuity of approach is important in providing certainty for industry. However, as identified by the ESC, there remains a number of items that require further examination. Origin's responses to these and other specific matters raised by the ESC are set out below.

Bad debts

As part of the 2021 VDO, the ESC made an upward adjustment of $6 to the retail cost benchmark to reflect the expected effect of COVID-19 on retailers' bad debt costs. Given the uncertain economic conditions and reduced Government support, the ESC questions whether the bad debt allowance remains appropriate going forward.

We note that recent economic forecasts for the domestic economy are generally more optimistic than at the time of the 2021 VDO.[1] However, forecasts are generally contingent on no large outbreaks of COVID-19. Recent outbreaks in Victoria highlight the ongoing uncertainty and potential fragility of the forecast economic recovery. This has obvious implications for residential and small business customers and consequently retailers' bad debt costs.

We also highlight our most recent half year results (February 2021) indicating the provision for bad and doubtful debts *… has been held for HY2021 with continued uncertainty relating to potential ongoing impacts of COVID-19, particularly the further roll-off of government assistance from March 2021.*

Given the uncertain economic environment we agree with the ESC that continued monitoring is required. We suggest that the ESC adopt a conservative approach and retain the existing bad debt allowance at least for the period 1 January 2022 to 30 June 2022 (if applied). This would allow the ESC to revisit its decision with up-to-date data in June 2022 without committing the allowance for greater than six months.

Wholesale cap contracts

The ESC proposes to again engage Frontier Economics (Frontier) to estimate wholesale energy costs using historical price movements to estimate cap contract prices. The ESC notes that ASX Energy has introduced new cap contracts to replace the existing cap contracts in March 2021 and the ESC proposes to investigate using the data from the newly listed cap contracts for the draft decision once these

[1] See for example RBA, 2021, *Statement of Monetary Policy*, May.

contracts are sufficiently traded. Origin generally supports the market approach used by Frontier and is therefore supportive of the ESC maintaining a consistent approach for the 2021 VDO.

We retain our view from previous submissions that regulated businesses should be provided with a reasonable opportunity to recover at least the efficient costs they incur in providing services and complying with regulatory obligations. We direct the ESC to arguments put forward in our previous submissions that Frontier's approach of taking the 50th percentile does not meet this regulatory standard.

One of the more significant challenges in transitioning to a financial year decision is that Q1 and Q2 wholesale costs are higher than wholesale costs averaged over a 12-month calendar or financial year. This is especially relevant in the event that the ESC makes a six-month transition from a calendar to financial year VDO calculation.

There are a number of options to ensure the transition to a financial year calculation does not result in an unnecessary fluctuation in prices while at the same time ensuring retailers are not exposed to undue financial risks. For example, the ESC could consider calculating an 18-month price to apply from January 2022, then updating this price for FY23 i.e., recalculating the 18-month price to apply from July 2022 using the previously calculated 6-month price, and an updated FY23 price.

Regardless, we consider that the ESC ought to instruct Frontier to consider alternative approaches to present to industry at a later point in the consultation, and preferable prior to its draft decision.

Retail operating margin

The ESC proposes to retain the existing benchmarking approach and maintain the retail margin at 5.7 per cent. This margin reflects an allowance for the risks faced by retailers operating in the market.

As the ESC has previously acknowledged, COVID-19 has increased the risks faced by retailers, notably that retailers carry the cash flow risk of the supply chain. As a result, debt-related costs of retailers have changed significantly due to COVID-19. To ensure retailers are not faced with a material systematic departure from efficient costs, the ESC included an allowance of $6 per customer in its current VDO. We supported this decision.

We believe COVID-19 debt-related risk persists. As a result, we urge the ESC to continue to ensure retailers are appropriately compensated for carrying the cash flow risk of the supply chain. We believe COVID-19-related bad debt risk can be accommodated either through the retail margin or as a separate cost allowance. We support a continuation of the current approach where the margin is retained at current levels and a discrete allowance included in retail operating costs to reflect the change in a retailer's risk. Assuming the ESC adopts a six-month regulatory period, more information should be available ahead of a longer regulatory period from July 2022.

Five-minute settlement

The ESC provided a one-off increase to retail operating costs of $0.84 per year per customer in the 2021 VDO to account for changes in the cost to serve relating to five-minute settlement. For 2022, the ESC consider that the one-off increase adequately accounts for any ongoing changes in the cost to serve relating to five-minute settlement.

We consider that to the extent that there are delays or changes to the start date of 5MS which result in increased costs to retailers, the ESC ought to retain this allowance.

Large-scale renewable energy target costs

Origin considers the ESC's proposed approach to estimate a benchmark for costs associated with the Large-scale Renewable Energy Target for 2022 to be reasonable. That is, multiplying the default renewable power percentage by the futures market price for large-scale generation certificates, with a true-up mechanism to account for the difference between the default and binding renewable power percentage.

Productivity factor

The ESC did not introduce a productivity factor to the retail operating cost component of the 2021 VDO and considers that it is again unnecessary for the 2022 VDO. Origin agrees with the ESC and considers that given the uncertainty of the current environment, the introduction of a productivity measure is not appropriate at this point in time.

Distribution and marginal loss factors

The ESC proposes to update its approach to calculating distribution loss factors in the Ausnet and Powercor distribution regions by using a weighted average of the short and long sub-transmission distribution loss factors in the regions. Origin supports the proposed update and agrees this is likely to provide a more accurate reflection of transmission losses in these rural areas.

In relation to marginal loss factors, we agree with the ESC's proposal to retain the existing approach.

Network tariffs

in addition to specifying a flat VDO tariff, the ESC proposes to continue the default two-period time of use VDO as outlined in the recent proposed variation to the 2021 VDO.

We consider that introducing a new time of use VDO to align with network tariff structures is a positive outcome and preferable to the existing compliant maximum annual bill arrangements. This should provide for a simpler, consistent, and more transparent tariff offer for customers and a simpler process for retailer compliance. We also consider that the ESC's variation proposal to use a new compliant maximum annual bill arrangement based on the time of use network tariff is appropriate for other non-flat tariff standing offers for the 2022 VDO.

Length of regulatory period

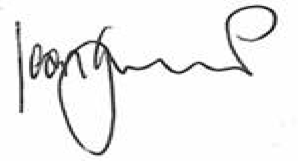
The ESC notes that it intends to align the VDO regulatory periods and Victorian network businesses' regulatory periods as soon as practical. To do so, the ESC identifies two options for the length of the regulatory period starting 1 January 2022: six months or 18 months.

Origin agrees that the timing of regulated retail prices and regulated networks tariffs should be aligned as soon as practicable. While there are additional costs and administrative issues for retailers and customers associated with changing retail electricity prices, we consider that a 6-month VDO for the period 1 January 2022 to 30 June 2022 is a lower risk approach in the circumstances. This would then be followed by a new 12-month determination for the period of 1 July 2022 to 30 June 2023. The shortened timeframe will provide alignment with the network pricing process and will also allow for better understanding of COVID-19 impacts and costs to be captured.

We look forward to working closely and cooperatively to support the ESC in its 2022 determination.

If you have any questions regarding this submission, please contact Gary Davies in the first instance at gary.davies@originenergy.com.au.

Yours sincerely



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