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

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2024-25 Victorian Default Offer: Request for Comment

AGL welcomes this opportunity to provide comments on the Essential Services Commission's (ESC) Victorian Default Offer 2024-25: Request for Comment (Consultation Paper), as published on 2 November 2023.

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.

AGL notes that the ESC is largely committed to using the same approach for calculating the 2024-25 Victorian Default Offer (VDO) prices as was used last year. The Consultation Paper is seeking stakeholder feedback on matters which stakeholders suggest the ESC could consider as part the pricing review.

AGL strongly believes the ESC should continue to preserve regulatory certainty and transparency by applying the current methodology for 2024-25, subject to the ESC restoring the retail operating margin back to the benchmark margin historically applied up to the 2023-24 draft determination. Further refinements are only necessary when material factors result in the current methodology failing to reflect cost changes.

Outlined below are our responses to the issues raised in the Consultation Paper.

Wholesale Costs

Consistent with previous VDO consultations, AGL continues to support the market-based approach used by Frontier to forecast the wholesale energy cost, including the continued use of trade-weighted ASX futures contract prices over the 12-month period.

Frontier's assumptions reflect many retailers' hedging practices of building contract positions over time and the ASX Energy futures contracts remain a reasonable proxy.

Whilst we support the ESC's proactive monitoring of a retailers approach to managing wholesale price risks, we consider the ESC should only use information gathering powers to access retailer cost data when there is a material change in retailer practices. Changes in practices can initially be identified through industry engagement, reviewing trading activity on the ASX exchange and brokerages, and consultancy advice. This will ensure that when the information gathering powers are exercised, the retailer's regulatory reporting cost is minimised and there is a clear purpose for the information reported to the ESC.

Retail Operating Margin

We note the ESC's final 2023-24 VDO determination changed the Retail Operating Margin from the draft determination rate of 5.7% to 5.3%. The primary reason for this change is the observation that other regulated retail margins have since lowered them to this level. The ESC further observed that the Market Offers tend to be lower than the VDO thereby inferring that the VDO retail operating margin could be lowered.

As explored in the 2019 Frontier study, the retail margin for electricity businesses represents the return that a retailer requires in order to attract the capital needed to provide a retailing service. The retail margin will vary between markets depending on the level of risk that a retailer faces in that market:

At the time of the 2019 Frontier study, the recommended benchmark, based on regulatory allowances, was derived from regulators that had made pricing determinations in a similar market to the VDO. Whilst the observed regulatory margin allowances in the 2023-24 determination are relevant, they are not a conclusive factor in deciding if the margin should be lowered. The ESC needed to determine whether the regulated price determinations had a similar level of risk to the Victorian market and why the prices were being regulated in those markets.

With this in mind, we do not consider the ESC had sufficient grounds to depart from the retail operating margin of 5.7%. We also note that there were significant factors against deciding on a lower bound margin. These included financial costs more broadly than wholesale credit support and economy wide increases in expected returns on capital.

At this stage, we support the ESC consulting on this issue and carefully considering an appropriate margin that does not risk undermining competition and innovation in the sector. However, with the options explored to date, there does not appear to be a viable alternative to the historically accepted 5.7% benchmark.

If you have any questions in relation to this submission, please contact Kyle Auret on kauret@agl.com.au.

Yours sincerely,

Chris Streets
A/ General Manager
Policy and Market Regulation