



13 April 2023

Ms Kate Symons  
Chair  
Essential Services Commission  
Level 37, 2 Lonsdale Street  
Melbourne Victoria 3000

Email: [VDO@esc.vic.gov.au](mailto:VDO@esc.vic.gov.au)

Dear Ms Symons,

**RE: 2023-24 Victorian Default Offer – Draft decision**

Origin Energy (Origin) appreciates the opportunity to provide a submission in response to the Essential Services Commission's (ESC) draft decision for the 2023-24 Victorian Default Offer (VDO).

Origin recognises the challenges faced by the ESC in making this draft decision amid the recent significant increase in wholesale market volatility. Managing the impact of higher energy prices and broader cost of living pressures, particularly for low-income households and vulnerable customers should be of the utmost priority. It is also crucial that this is primarily done through targeted programs such as concession schemes, customer hardship frameworks and direct bill subsidies.

Certainty is a basic prerequisite of good regulation and provides a stable investment environment. We fully support the ESC retaining its current method to calculate the VDO in the current circumstances to meet this important regulatory principle.

In terms of the wholesale cost allowance, we support the ESC continuing with its current approach. The ESC's approach of using a book build of trade weighted ASX contract prices has been effective in capturing retailers' actual costs of purchasing electricity during this period of shifting market dynamics and extreme price volatility.

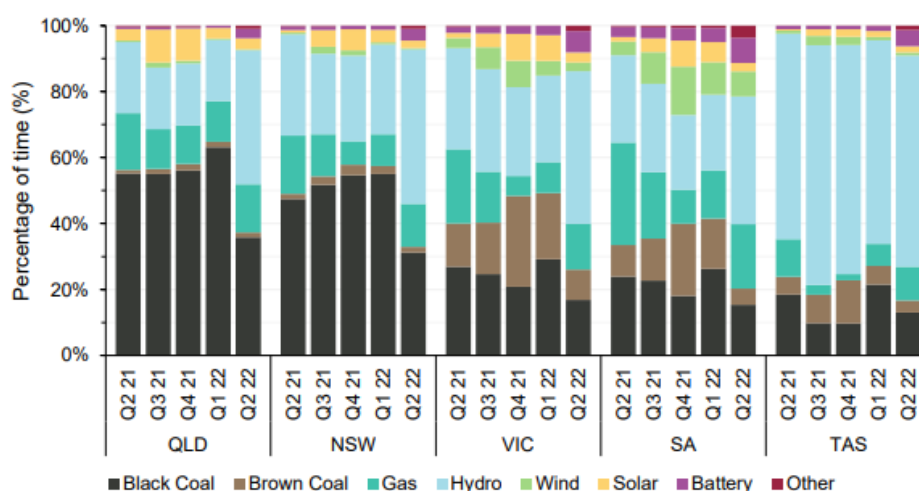
We support the ESC's decision to improve the accuracy of its retailer costs calculation by utilising data that retailers already provide to the ACCC as part of their ongoing market monitoring. We also support the retention of the current approach to the calculation of network costs and environmental costs.

Additional commentary on these and other matters contained in the ESC's draft decision are provided below.

## 1. Wholesale Energy Costs

- [1] Wholesale energy markets have seen unprecedented volatility since early 2022 leading to shifting market dynamics and extreme price volatility. The ESC's approach of using a 12-month book build of trade weighted ASX contract prices has been effective in capturing a retailer's actual costs of purchasing electricity during this period for the purposes of deriving the VDO.
- [2] The market volatility and uplift in wholesale energy costs over 2022 was driven by a broad range of factors. Most notably, a series of plant outages, coal supply constraints, and reduced renewables output in the electricity market led to a material increase in the reliance and consequent utilisation of higher (relative) cost gas-powered generation and hydro resources.
- [3] While Q2 typically sees higher levels of seasonal planned maintenance on thermal generation units in preparation for winter, several unplanned outages of coal-fired units occurred that saw approximately 6.4GW of coal generation being offline in June 2022.<sup>1</sup> This equated to approximately 28 per cent of total installed coal capacity in the NEM.<sup>2</sup>
- [4] As noted by AEMO, this high level of outage rates had multiple and compounding impacts on spot prices, as it removed lower cost supply from the market and increased the dispatch of higher-priced supply from other generators.<sup>3</sup> This is evidenced by the significant fall in the frequency with which black or brown coal-fired generators set prices in Victoria (and the NEM more broadly). The percentage of time brown coal generators set the price in Victoria more than halved from the previous quarter. Conversely, gas and hydro generators set the price 60 per cent of the time during Q2 2022. This was a significant increase from 35 per cent of the time in Q1 2022. These changes in price setting are highlighted in Figure 1.

Figure 1: Price setting by fuel type Q2 2022<sup>4</sup>



- [5] This also occurred at a time when broader geopolitical issues were already putting upward pressure on fuel prices, with the onset of cooler weather and associated seasonal uptick in gas demand further contributing to higher spot pricing outcomes in the facilitated gas markets. Spot prices in the Victorian Declared Wholesale Gas Market (DWGM), which is relied on for fuel supply

<sup>1</sup> Australian Energy Market Operator, Quarterly Energy Dynamics Q2 2022, p. 16.

<sup>2</sup> Proportion based on an installed coal capacity of 22,755MW, as reported in AEMO's NEM Generation Information February 2023 workbook.

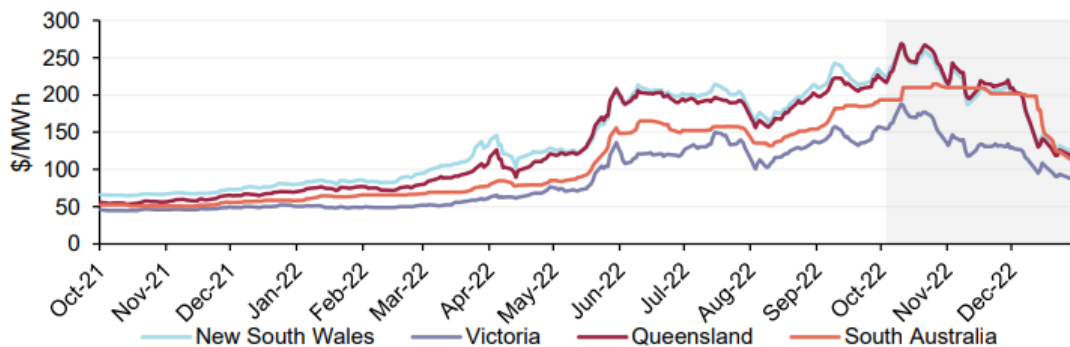
<sup>3</sup> Australian Energy Market Operator, Quarterly Energy Dynamics Q2 2022, p. 16.

<sup>4</sup> Australian Energy Market Operator, Quarterly Energy Dynamics Q2 2022, p. 21.

during high demand period, averaged approximately \$29/GJ in Q2 2022, 299 per cent higher than Q2 2022 levels.<sup>5</sup>

- [6] The price for hydro also increased as hydro generators increased prices in order to manage the risk of overly depleting their water reserves and to reflect the changing opportunity cost of water in storage.
- [7] Notwithstanding, Victoria having a significant amount of relatively low-cost brown coal generation, the price of generation in the NEM is set by the marginal supply source. An outworking of the above is that wholesale spot prices averaged \$264/MWh and \$216/MWh in Q2 and Q3 respectively across all NEM regions, making these the highest and second highest quarters on record.<sup>6</sup> Figure 2 below also highlights the increase in Cal2023 base future prices observed over the equivalent period, with AEMO noting high spot prices and volatility, coupled with generator availability concerns and higher fuel cost expectation, drove up short- and long-term futures prices in Q2 2022.<sup>7</sup>

**Figure 2: ASX Energy – daily Cal 2023 base futures by region<sup>8</sup>**



- [8] We believe the ESC's approach of an efficient hedge portfolio with a book build using trade weighted ASX contract prices has determined an estimate of wholesale costs that a prudent retailer would face over this volatile period. We support the continued use of this approach.

### 1.1 Market Intervention Costs

- [9] The period of market suspension and administered pricing in 2022 resulted in around 500 separate market interventions from the Australian Energy Market Operator (AEMO), the cost of which will need to be recovered from customers. This includes the costs associated with compensation claims made under the two different cost recovery mechanisms. It is likely these costs will be material, but the timing of when all costs will be known may be too late for the ESC to include them in the final VDO. Should this occur, retailers could be left with significant holding costs. To mitigate this risk, the ESC should include an allowance for working capital for any market suspension costs not included in this VDO.

<sup>5</sup> Australian Energy Market Operator, Quarterly Energy Dynamics Q2 2022, p. 40.

<sup>6</sup> Australian Energy Market Operator, Quarterly Energy Dynamics Q3 2022, p. 3.

<sup>7</sup> Australian Energy Market Operator, Quarterly Energy Dynamics Q2 2022, p. 22.

<sup>8</sup> Australian Energy Market Operator, Quarterly Energy Dynamics Q4 2022, p. 18.

## 2. Retail Costs

- [10] We have previously supported the ESC's approach to escalate the current retail operating costs by inflation. Notwithstanding, we recognise the ESC preference to improve the accuracy of the retailer costs calculation by accessing and utilising the appropriate data sets.
- [11] In the case of retail operating costs and bad and doubtful debt, retailers already provide the relevant data to the ACCC as part of their ongoing market monitoring. We support the ESC using this data acquired through its own data collection processes that is consistent with the costs reported to the ACCC by retailers.

## 3. Network Costs

- [12] Unlike wholesale costs, network costs are known in that the AER approves the network prices that will be applied to retailers and customers for the forthcoming year. They are known prices that are not subject to forecast error.
- [13] For these reasons, we support the ESC's position to pass-through a retailers' network costs in the VDO by using the AER's approved tariffs in its final decision. This approach ensures retailers can recover their actual costs.
- [14] In the event this is not possible because of timing issues associated with the AER's approval of network prices, the ESC ought to use the annual network tariffs submitted by the network businesses to the AER and apply a "true-up" to account for any differences between proposed and approved network tariffs in future years.

## 4. Environmental Costs

- [15] We support the ESC continuing to use its current method to determine Small Scale Renewable Scheme costs, Large Scale Renewable Scheme costs, and Victorian Energy Upgrade costs.

If you wish to discuss any aspect of this submission further, please contact Sean Greenup ([sean.greenup@originenergy.com.au](mailto:sean.greenup@originenergy.com.au)).

Yours Sincerely,



Steve Reid  
General Manager, Regulatory Policy