12 April 2022

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: VDO@esc.vic.gov.au

Dear Chairperson and Commissioners,

Victorian Default Offer 2022-2023 – PUBLIC VERSION

EnergyAustralia is one of Australia's largest energy companies with around 2.4 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.

We welcome the opportunity to provide this submission to the ESC's Draft decision on the Victorian Default Offer (VDO) 2022-2023 (Draft decision). Our submission below comments on the issues of:

- Depreciation and amortisation
- Costs of CDR implementation
- The meter cost issue addressed in the Draft decision.

Draft 2022-23 VDO determination

1. Depreciation and amortisation (D&A)

As previously raised in past VDO consultations, we continue to have concerns that the VDO does not provide for sufficient depreciation and amortisation (D&A) in the retail margin (EBITDA).

The Commission provides for D&A, nominally, in the VDO's EBITDA. The VDO's EBITDA (5.7%) is calculated using Frontier's Expected Returns Approach (which aligns with IPART's 2013 approach). As a cross-check, Frontier also calculated EBITDA by benchmarking it with previous *regulator decisions* on EBITDA (mainly IPART's 2013 decision).

It is our strong view that D&A should be benchmarked against *actual, current D&A data provided by Retailers*. This is fundamental to ensure the VDO is "based on the efficient costs of the sale of

electricity by a retailer".[1] It is unclear if the Commission has undertaken this benchmarking/cross check.

We expect the D&A amounts used for the VDO methodology are very outdated, given they are based on Tier 1 Retailer data from 2013 (used by IPART and SFG Consulting).[2]

[Confidential:

]

The ESC previously acknowledged that D&A might need to be revisited, in November 2020:

> The VDO allows for the benchmark Retailer to undertake some level of capital expenditure. While cross-checking the retail margin using the expected returns approach, the capital expenditure less depreciation was assumed to be 0.52% of expected total costs in each year. Therefore we expect that the current level of retail margin compensates Retailers for cash outflows associated with efficient capital investments.
>
> In addition, the pricing order does not require us to determine tariffs based on the actual costs of a Retailer. However, to consider the impact of any change in capital expenditure we need to identify long term trends in depreciation and amortisation reported by Retailers over a period. In order to do this we will explore whether Retailers will be required to provide information on the depreciation costs of their retail operations in future cost data requests.[3]

The Commission has said they have not observed any material changes to D&A reported by Retailers. However, no changes in Retailer's D&A data from year to year, does not validate or confirm that the Commission's approach to EBITDA was adequate to begin with. We ask the Commission to look beyond just monitoring for changes to D&A, and to check that EBITDA sufficiently covers actual D&A.

It is also important to note:

- Technology is a large proportion of capital expenditure (capex) (and D&A) for Energy Retailers.
- EnergyAustralia, like other Retailers, continues to invest in technology assets to support its retail business. We accept that the Commission would only provide for capex where there is a demonstrated productivity gain from those investments.
- However, a major source of technology capex comes from large regulatory changes which are mandatory. This is because Energy Retailers rely on technology systems to interact with customers and those interactions are heavily regulated. Further Energy Retailers rely on technology systems to interact with the energy market and market operator. Examples of technology heavy reforms include the Consumer Data Right, better bills, five minute and global settlement, and Power of Choice reforms. These technology heavy reforms are expected to continue with the Energy Security Board's (ESB) market design reforms, estimated to cost AEMO between $250-330 million[4], with corresponding changes to Retailer systems. Any capex (and D&A) associated with regulatory reform should be adequately

[1] Clause 12(3) VDO Order in Council
[2] SFG Consulting Report for IPART: *Estimation of the regulated profit margin for electricity retailers in New South Wales (nsw.gov.au)
[3] See Victorian Default Offer 2021 Final Decision 25 November 2020, p 41, available here: Victorian Default Offer price review 2021 | Essential Services Commission
[4] 1629944958-post-2025-market-design-final-advice-to-energy-ministers-part-a.pdf (aemc.gov.au) p 53. For more detail, see 1629945838-post-2025-market-design-final-advice-to-energy-ministers-part-c.pdf (aemc.gov.au) p 59

reflected in the VDO, in line with the VDO already reflecting the Retail operating cost for regulatory reforms e.g. VDO's specific provision for five minute settlement.

We also question the differentiation between the treatment of Retail operating cost reported by Retailers, which the Commission cross-checks the VDO against; and capex which it does not. Both are costs of supplying electricity and relevant to the VDO determination. The same regulatory requirement may be treated as Retail operating cost by one retailer and as capex by another.

A detailed explanation of the issue is below.

Under accounting standards, capex on retail technologies is amortised over future periods depending on their useful lives. To illustrate and contrast:

- Retailer 1 may invest in a billing platform which will return benefit over a number of years. This is capitalised and the payment for that system would be entered into the balance sheet in the first year but then expensed over multiple years via D&A in the profit and loss statement. In this case, the cost of the billing system will not be categorised as operating expenditure (opex) under the VDO.
- Conversely, Retailer 2 may instead not invest in a billing system but outsource its billing requirements to a third party e.g. use software as a service. The Retailer pays an annual fee which is treated as an opex item. This means the VDO's Retail operating costs will be cross checked against it.

The technology costs incurred by Retailer 1 and 2 (as capex or opex) should both be considered relevant when determining the VDO. The difference in accounting treatment is irrelevant for the purposes of recovering efficient costs under the VDO.

2. Implementation cost of the Consumer Data Right

The Commission's draft decision states it will not include an adjustment for ongoing operating costs associated with the Consumer Data right, based on cost estimates provided by Treasury to the Office of Best Practice Regulation. The Commission seems to be focussing on Retail operating costs and not capital costs, which we disagree with, as discussed above. [Confidential:
].

We emphasise the substantial size and cost of the CDR. It is a completely new data access regime which requires Retailers to:

- standardise the data they have,
- meet new customer ID verification requirements to make sure the person requesting the data is the customer,
- respond to data requests via new API infrastructure which must meet banking level security standards, and
- engage with the customer via a new digital dashboard and also engage in non-digital ways e.g. to answer complaints etc.

We will have better data on actualised costs of the CDR after the due date of 15 November 2022. However, we anticipate the cost could be comparable to the five minute settlement reform which the Commission did provide for in an additional Retail operating cost item. [Confidential:

]

Treasury's estimates of the cost of CDR appear grossly understated. They were modelled on confidential information provided by Retailers and an established third party service provider that offers solutions to Data Holders (Retailers).

This is problematic because:

- Early cost estimates provided to the ACCC/Treasury in August 2020 were highly approximate. At that stage Energy Retailers might not have decided their architectural solution. Further, in April 2021 the data access model changed so that responsibilities allocated to AEMO would be re-allocated to Retailers, increasing cost estimates. Care should be taken to ensure that any cost estimates used post-date the change in data access model. EnergyAustralia's single cost estimate does not.

- Treasury estimated $825,000 or $2.42 million per retailer in costs depending on whether the CDR implementation was outsourced to third parties or self-built, respectively. [Confidential:
]

- We caution basing cost estimates on third party costs. This might ignore that much of the CDR implementation cannot be outsourced. Retailers need to prepare their data and reconcile their customer records to integrate into third party solutions. Regardless of the maturity of a Retailer's technology platforms, a substantial amount of the solution must still be done at the Retailer's end and cannot be outsourced.

Even assuming Treasury's estimates are reasonable, we cannot reproduce the Commission's estimates.

Treasury estimates that the cost to energy retailers will be $30.1 million across the sector over three years. This appears to be completely insufficient considering our costs alone. However, based on Treasury's number of $30.1 million, we roughly calculate around $3 per customer, or $1 per customer per year for three years in implementation cost.[5] This cost should be fully accounted for under either opex or capex as it is a mandatory regulatory requirement.

Instead, the Commission has calculated the ongoing Retail Operating cost (i.e. opex) of the CDR only, at 4 to 7 cents per customer which seems too low. [Confidential:

].

We attach a confidential spreadsheet outlining our costs for the Consumer Data Right, with items categorised as capex or opex (total cost is in cell EG137). We recommend the Commission obtain updated CDR cost data from Tier 1 Retailers.

3. Metering cost issue

We welcome the Commission's change in approach with regard to metering costs which reflects that Standing Offer customers are often not on the cheapest metering configuration (Single phase single element meters (SPSE meters)). We commend the Commission on being open to changes to the VDO, as new data becomes available.

[5] Rough estimate of $30.1 million divided by 10.1 million customers in the National Electricity Market, from Figure 6.2, State of the energy market 2021 (aer.gov.au)

Weighting the metering cost in line with the proportion of meters in use, is a positive step which will help to improve the VDO and ensure metering costs are not understated in the VDO.

However, we encourage the Commission to adopt a further level of detail to reflect the full metering cost issue. If this is not possible for the next 2022-23 VDO, then we would support the Commission adopting the approach described in its Draft decision, with a view to moving to further changes if required for the 2023-24 VDO.

The Commission's approach does not reflect that some customers have more than one meter and Retailers are paying for the cost of two meters for those customers. The Commission also does not attempt to calculate the SPSE vs non-SPSE meter split separately for small business and residential customers which could result in residential customers cross subsidising small business customer meter cost. More detail on both these issues is below.

3.1 Commission's approach does not reflect that some customers have more than one meter

As discussed in our previous submission, the issue is not only that more expensive non-SPSE meters are charged to a proportion of Standing Offer customers.

There is the further issue that for a proportion of customers (in at least one Distributor Network Service Provider's (DNSP) zone), the customer is being charged for two meters. It is unclear why this is the case, but we expect this is due to how the DNSP updated customer meter configurations during the smart meter rollout (installing an extra meter rather than consolidating circuits to one upgraded meter). Whatever the case, Retailers are being charged for two meters for one customer, and the VDO is only allowing for the cost of one meter per customer. This would mean a clear under-recovery in metering cost for those customers.

Our data shows that [Confidential:

]. The Commission might have had challenges in finding publicly available data to verify the multiple meter issue. However, the Commission can verify that this is a valid issue using a simple check - divide the number of meters by the number of customers.[6]

Based on Ausnet's information:

- this shows more than a one to one ratio, approximately 1.017 meters per customer which reflects that some customers have multiple meters (see highlighted cell in Metering Spreadsheet 2).
- Weighting the Commission's draft metering cost further for this ratio (note this is for Ausnet only, the exercise would have to be done across all DNSPs), would produce an average cost per customer of $74.19 not $72.90 (see highlighted cells in Metering Spreadsheet 2). This is a difference of about $1.30 which is not immaterial, particularly when considering the Commission has reflected smaller changes in the past e.g. allowance for 5 minute settlement which was only $0.84.

[6] Approximate count of 777,000 customers in the Ausnet zone which have meters assets from Ausnet (not a third party). We used the public document "AusNet Services - Attachment 3 - 2021-22 Tariff Approval Model - SCS - PUBLIC - June 2021_0.xlsm" (https://www.aer.gov.au/system/files/AusNet%20Services%20-%20Attachment%203%20-%202021-22%20Tariff%20Approval%20Model%20-%20SCS%20-%20PUBLIC%20-%20June%202021_0.xlsm)
In the tab "Prop DUOS", it lists all the tariffs and the count of customers on this tariff (Col T).
We excluded C&I customers and medium customers which most likely have third party metering, approximately 2,000. This provides around 777, 000 residential and small business customers that have Ausnet meters.

The Commission could adopt the $74.19 amount (adjusted for all DNSPs) and this would be a reasonable approach based on publicly available data. Alternatively, the ESC could undertake further calculations to separately calculate the residential and small business customer metering cost, to at least ensure that no material cross subsidisation is being paid by residential customers, discussed more below.

3.2 Separate meter cost calculations for residential and small business customers

The Commission's approach of weighting based on installed meters (for SPSE vs non-SPSE meters) overlooks that the non-SPSE meter issue impacts small business customers more, which means that residential customers could be cross subsidising the higher meter costs of small business customers.

The Commission could request data from DNSPs to assess whether not distinguishing between residential and small business customers is material.

This would involve three steps:

1. Calculate the proportion of residential customers with SPSE vs non-SPSE meters, and repeat the same for small business customers. This would require obtaining data from DNSPs on the numbers of customers on a residential network tariff with SPSE and non-SPSE meters, and obtaining the same for small business customers.
2. Calculate the separate weighted metering cost (SPSE vs non-SPSE) for residential and small business customers, based on the proportions provided in 1.
3. Further adjusting meter costs for the multiple meter issue by also requesting from DNSPs the ratio of meters to residential customers, and multiplying step 2 by this ratio. The same would be repeated for small business customers.

[Confidential:

].

If separating the data for residential and small business customers shows material differences/cross subsidy, the Commission could explore setting a different metering cost for residential and small business customers under the VDO tariffs.

If you have any questions in relation to this submission, please contact me (Selena.liu@energyaustralia.com.au or 03 9060 0761).

Yours sincerely,

Selena Liu
Regulatory Affairs Lead