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Victorian Default Offer 2025 – 26: Request for comment

Essential Services Commission

Submission via engage.vic.gov.au

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AGL Response to Victorian Default Offer 2025 – 26 prices: Request for Comment paper

AGL Energy (**AGL**) welcomes the opportunity to comment on the Victorian Default Offer (**VDO**) prices 2025 – 26: Request for comment paper (**consultation paper**).

Proudly Australian for more than 185 years, AGL supplies around 4.1 million energy services. AGL operates Australia's largest private electricity generation portfolio within the National Electricity Market (NEM), comprising coal and gas-fired generation, renewable energy sources such as wind, hydro and solar, batteries and other firming technology, and gas production and storage assets. We are building on our history as one of Australia's leading private investors in renewable energy to now lead the business of transition to a lower emissions, affordable and smart energy future in line with the goals of our Climate Transition Action Plan.

We support the ESC proposal to use generally the same methodologies as in past reviews. The ESC's regulatory pricing approach has largely been consistent and transparent since this pricing role was created. Subject to some concerns regarding the market integrity of the VEU, particularly for the calendar year 2025 reporting year, we do not think there is a material change in circumstances that warrant any changes to the VDO methodology.

Attached to this letter is our response to the questions raised in the consultation paper. We look forward to further engagement with the ESC and industry on the VDO pricing methodology.

If you have any queries about this submission, please contact [redacted].

Yours sincerely,

Ralph Griffiths
General Manager, Policy and Market Regulation

ATTACHMENT: Response to consultation paper

1. Do you support the Victorian Default Offer estimating retail operating costs separately for domestic and small-business customers?
We submit that regulatory consistency has significant benefits (unless change is required). Whilst there is merit in continuing to monitor the underlying cost drivers of the retail operating costs for residential and small-business customers, we do not consider there is a strong case to change the methodology to make this cost distinction at this stage. The ESC should first build a reliable data set to inform any potential changes in methodology, the analysis of this data should then inform the ESC as to the benefits in separating these customer type costs and whether there is sufficient information to make this change in the methodology.
2. What are your views on the appropriateness of the current retail operating margin and where should it sit within a feasible range?
We submit that the retail margin should be materially increased to reflect the risk faced by retailers, and should be assessed along with all of the other elements of the cost stack. As noted in the consultation paper, the VDO price must be based on efficient costs of sale by a retailer. The retail operating margin should reflect the efficient rate of return in a competitive retail market. As the energy transition progresses, risks are increasing rather than decreasing. Setting the VDO at a level that is too low risks jeopardising the retail competition and innovation that benefits consumers. In particular, innovation in retail offerings is key to providing consumer choice and facilitating evolution of retail products to respond to consumer preferences in light of the ongoing development of consumer energy resources. Retailers are also facing considerable uncertainty and risk given the progress of transition continued build out of new energy resources, including variable renewable generation, and ongoing potential for unpredictable event to cause wholesale market volatility. Changes of this scope and magnitude tend to increase risk, and the VDO is not equipped to respond to unpredictable events in the short term. This increases the importance of ensuring that the VDO is not set at a level that is too low to allow retailers to appropriately manage their risk and achieve a reasonable rate of return. The Consultation Paper states that observed margins across the industry have decreased in recent years. Such a trend should not form the basis for a reduction in the retail margin determined by the ESC for the purposes of the VDO. Whilst the observed margins reflects competition in the market, they may not be a good proxy for risk. As highlighted in previous submissions, we do not consider the retail operating margin benchmarks are an appropriate rate of return for the Victorian retail electricity market. The ICRC analysis is not appropriate for the Victorian market as the relevant circumstances differ between Victoria and the ACT. Setting aside our disagreement with this previous benchmarking methodology decision, we do not consider there are circumstances that would justify a further reduction of the rate of return to the lower rate. To the contrary, there remain significant and ongoing risks facing retailers. For example, ongoing changes to regulations and market conditions mean retailers are operating with significant uncertainty as to the future regulatory settings and market dynamics. One example (as noted below) is the Victorian Energy Upgrades Program, where it is becoming increasingly difficult for retailers to acquire the number of certificates required to avoid paying default penalties

3. Are there any other considerations we should have in determining a retail operating margin for an efficient electricity retailer?
See above response to question 2.
4. Is there a better approach to estimating Victorian Energy Efficiency Certificate prices?
VEU Market conditions remain extremely challenging due to the many changes to the VEU over the past few years, resulting in significantly lower VEEC creation volumes, ongoing liquidity issues in the market and ongoing reliability issues of forward contract delivery. As has been acknowledged by the industry, these market failures are leading to significant challenges in relying on a historically established retailer strategy to attain the number of certificates needed for surrender at the end of each reporting period. The VDO VEU price benchmarking methodology is based on a historical 12-month volume weighted spot price. This benchmarking approach presumes a prudent retailer can access certificates through the spot market during each calendar reporting year. As the ESC has also noted, retailers are also able to acquire forward contracts that may be below the spot price. The benchmarking approach is therefore a good proxy to forecasting retailer costs when both the forward and the spot markets are working correctly. Shortfalls in expected certificates due to poor forward contract deliveries is leading to retailers acquiring certificates through the spot market to meet these shortfalls. The timing of the acquisition from the spot market in these circumstances is a direct result of when the forward contract shortfalls are realised and not based on a prudent retailer's acquisition strategy. The volume weighted spot price does not reflect this market risk, as unexpected shortfalls remove the flexibility for the retailer to implement a prudent acquisition strategy. Market expectations for the 2025 calendar year are that there is insufficient certificate creation to meet retailer obligations. In the absence of a market intervention, this will mean there will be a systemic shortfall within the market. This will mean a prudent retailer will likely be exposed to the tax effective penalty for the shortfall in certificates they have been unable to obtain during the reporting period. Whilst we note there are several policy options currently being explored for calendar year 2026 and onwards, these policy interventions will not entirely address this issue for the VDO 2025-26 pricing period. The above issues are also leading to a significant uplift in the 'cost of carry' to hold onto these certificates up to the surrender date. This is simply due to the greater amount of capital needed to acquire certificates (and hold them to the date for surrender). These issues demonstrate that the benchmarking approach to deriving the VEEC price is no longer a reasonable representation of the retailer costs to meet this obligation. Whilst market based metrics are the best proxy to determine retailer costs, this is only suitable when the market is functioning correctly. Given the current market uncertainty, forward market volume failures, the likely certificate volume shortfall in calendar year 2025, and the continued upward increase in certificate prices towards the tax effective penalty certificate price, the ESC should apply a conservative and prudent cost price forecast for the 2025-26 pricing period. Given the significant challenges in relying on market pricing metrics we consider the tax effective penalty price provides the best price forecast that effectively reflects the market conditions faced by retailers.
5. Does the removal of solar exports from the load profile better reflect an efficient retailer's load profile assumptions?

We refer to our response below to question 6. We note the importance of regulatory consistency where possible and that changes in fundamental aspects of the regulatory framework could have material, and unpredictable, consequences.
6. Do electricity retailers exclude solar exports from their load profile when buying future wholesale electricity contracts?
Retailers’ wholesale spot market payment obligations are based on their net load profile (including solar exports). In light of this, AGL manages spot price risk associated with its net load profile (including solar exports) of its customer portfolio. One avenue to managing this spot price risk is through purchasing future wholesale electricity contracts.