01 June 2023

Clare Savage
Chair
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Submitted by email: AERRoLR@aer.gov.au

Dear Ms Savage

Application for a RoLR cost recovery scheme

Please accept Origin Energy's submission for the recovery of costs attributable to the Elysian Energy Pty Ltd Retailer of Last Resort (RoLR) event.

On 1 September 2022, the AER issued a RoLR Notice under the National Energy Retail Law (NERL) in relation to Elysian Energy (the RoLR event). The AER's Notice advised that on 2 September 2022, 1,557 customers of Elysian Energy were deemed to have transferred to the Designated RoLR for each relevant distribution network.

Origin Energy Electricity Limited (Origin) is the Designated RoLR for customers in NSW connected to the Essential Energy and Endeavour Energy electricity distribution networks respectively and also for customers connected to the Energex distribution network and the South Australia Power Networks.[1] Following the RoLR event, AEMO initiated a bulk transfer of 1,557 Elysian Energy customers to Origin.

Origin Energy is applying for the recovery of $401,849 in costs incurred as a direct result of the Elysian Energy Australia RoLR event less an amount of $38,098 to be borne by Origin providing for a net application of $363,751.

This was one of the seven retailer failures that occurred over the second half of 2022. These occurred in a period of significant price volatility and market instability from the war in Ukraine driving high international gas and coal prices, coal plant closures, and more frequent unplanned outages. While the quantum of this application for cost recovery is modest, we are currently assessing the impact of the subsequent six failures which we believe the cumulative cost impact will be material.

The details of this application are provided below and in the attached completed RoLR cost recovery pro forma template.

NERL and AER Guidelines

The NERL and the AER's RoLR Guidelines provide for the establishment of a RoLR cost recovery scheme and for the recovery of RoLR scheme costs. Specifically, an application must include the following:

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[1] AER Reference TE12028.

- The quantum of costs and benefits accruing to the RoLR including supporting documentation verifying this information.
- The RoLR cost recovery Scheme.
- The level of costs borne by the RoLR.

Quantum of Costs and Benefits

Origin's costs relating to the Elysian Energy RoLR event are: 1) administrative costs associated with establishing the customer accounts in Origin's customer and billing systems and preparing and sending customer correspondence; and 2) costs of providing energy to the customer such as network and wholesale costs. Origin's benefits are calculated as the revenue income from energy sales. These are summarised in table 1.

Table 1: Origin RoLR Event Costs and Benefits

Description	Quantum
RoLR Administrative Costs	$183
Wholesale and Network Costs	$1,520,334
Total Costs	$1,520,517
less Total Revenue	$1,118,668
less Costs Borne by Origin	$38,098
RoLR Cost Claim	**$363,751**

Cost Assumptions

The AER's RoLR Guidelines require that a RoLR must provide supporting documentation showing how such costs have been incurred due to the retailer's responsibilities as a default RoLR. Further, if the preparation costs provided are estimates, a RoLR must provide information explaining on what basis the cost estimates have been made.

The Elysian Energy RoLR event has led to additional costs of integrating the inherited customers into Origin's customer and billing systems and also the costs of managing the electricity pool price exposure.

With respect to the administrative costs, Origin has applied the following assumptions:

- Where a customer has churned between when the RoLR event was called and when all customer information had been received and loaded into Origin's billing system, Origin has not sought to recover these costs from the customer but has included these as part of this application.

With respect to wholesale costs, Origin has applied the following assumptions:

- A starting inherited customer value of 929 which excludes transferred customers where Origin didn't become the FRMP (Financially Responsible Market Participant), lost FRMP or the customer moved from a standing offer.
- Monthly actual churn rates for the inherited customers.
- A wholesale cost estimate calculated using the ASX quarterly baseload electricity future price as at the RoLR date multiplied by an estimated mass market load weighting factor. The load-weighting factor is a ratio comparing the average pool price cost per MWh of supplying a mass market customer using their time-of-day load profile to a flat time weighted average price. This is applied to the average annual consumption (sold volume) by customer segment and

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distribution zone for Origin's portfolio as of May 2022, multiplied by estimated loss factors to convert to purchased load.

- When forecasting all sold electricity Retail load, the estimated shape of demand and pool price capture of mass market customers is incorporated into the position, therefore the load weighting factor should also be taken into account when estimating the change to the position from inheriting RoLR customers.
- When forecasting mass market electricity demand for wholesale hedging purposes, the volumes include the impact of loss factors (purchased volume) and therefore should be applied to the estimated average consumption (which does not include loss factors)
- The cost of the additional renewable energy target certificates required due to increased load from RoLR customers has been estimated using trade weighted market prices of the certificates multiplied by the additional certificates required.
- Origin is seeking wholesale cost recoveries to the end of 30 June 2023. This period extends beyond the date of submission of this application (9 months after the RoLR date) since hedging activity would cover anticipated changes in forecast load beyond the period to the date of submission.
- Origin conducts its hedging holistic to its entire portfolio. Due to the ongoing and dynamic nature of hedging activity which covers many changes in the whole portfolio, in contrast to individual ROLR events, it is not possible to precisely identify hedges and quantify all costs for each RoLR event, in relation to the entire portfolio. Any increases in customer load would in principle be hedged as it comes into the portfolio, however in practice this may not be the case. The proposed methodology captures the essence of our cost dynamics under changing conditions by using available market data available at the time of the RoLR events.
- In principle, Origin hedges any changes in the forecast load immediately at market rates to manage the portfolio to a target risk position. Therefore, it follows that using the market price of ASX quarterly futures on the ROLR date is a reasonable estimate for this cost.

Revenue Assumptions

With respect to Origin’s benefits (revenue), these have been calculated as:

- Sales volume calculated using the average annual consumption (sold volume), by customer segment and distribution zone for Origin portfolio as of May 2022.
- Variable and fixed revenue based on an Origin portfolio average of standing rates (DMO equivalent tariff) for the distribution zone and segment.
- Residential and SME fixed and variable NUOS (Network Use of System) based on Origin portfolio average for each respective network.
- DMO is based on consumption benchmarks for Residential & SME customers in different distribution zones. Origin portfolio usage is different to benchmark consumption in the DMO, Origin portfolio average takes into account Origin forecast usage for our customers on all tariff types (such as flat, TOU and controlled load).

Further details relating to Origin’s costs and benefits are provided in the AER’s pro forma excel spreadsheet attached to this submission.

Cost Recovery Scheme (recommended methodology)

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The AER's Guidelines require a RoLR to propose the cost recovery mechanism as part of an application for the recovery of scheme event costs. Origin is applying for a distributor payment determination as the cost recovery scheme for the recovery of all its scheme event net costs associated with this application.

The AER's RoLR Statement of Approach sets out general principles the AER will consider when making a cost recovery scheme determination. This application addresses each of these principles below.

Consideration of price shocks for small customers

The AER must consider how the RoLR balances achieving the national energy retail objective with the application of consumer protections for small customers, including but not limited to protections relating to hardship customers.

Therefore, on the one hand the AER must promote efficient investment and use of energy services and on the other it must consider the impact on consumers. The latter being an assessment of how to treat social costs. In this regard, the social costs from RoLR events are, above all, a problem that concerns the entire energy sector. They constitute a collective problem whose resolution demands a collective response.

The AER specifies that RoLR cost recovery should not result in onerous price shocks for small customers, as this may present hardship issues for some customers. For this reason, the AER does not consider upfront fees are appropriate where the fee imposed is onerous for the transferred small customers of the failed retailer. We agree.

Because the RoLR scheme benefits all energy market participants, it is appropriate that for the recovery of costs to extend beyond the customers of the failed retailer, and for these costs to be treated as a social cost. Applying upfront fees to the customers of a RoLR is punitive. Not only have these customers experienced the inconvenience and potential loss of benefits of their original contract, but they could also be potentially forced to directly pay for the failure of that retailer as well.

For these reasons, we do not consider upfront fees are appropriate. We propose that RoLR event costs ought to be socialised across the entire network customer base through a distributor payment determination. As a result, the applicable RoLR costs will be smeared across the customer base of the relevant distribution network. This provides for a recovery of $0.14 per residential customer for Essential Energy; $0.08 per residential customer for Endeavour; $0.07 per residential customer for Energex, and $0.10 per residential customer for SA Power Networks.[2] We believe this approach meets the criteria of avoiding price shocks and allocates the costs of providing scheme benefits to all customers.

Extent of recovery of costs

The AER states that to avoid significant price shocks for small customers, cost recovery should occur over the largest customer base which is appropriate to the RoLR event. As argued in the above section, the allocation of costs using a distributor payment determination meets this objective.

A RoLR scheme benefits all energy market participants by providing market integrity and security following a RoLR event. For these reasons it is appropriate that cost recovery extends beyond just the customers of the failed retailer. The most practicable method to allocate these costs is to include them in the distributor's annual allowable revenue allowance which in turn will facilitate these costs being socialised across applicable customers in a non-discriminatory manner.

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[2] Based on residential customer numbers of 959,048 as per Endeavour Energy 2022-23 Pricing Model, sheet 'Actual', cell N46; and 771,827 as per Essential Energy 2022-23 Pricing Model, sheet 'Actual', cell N46, 1,402,509 as per Energex Energy 2022-23 Pricing Model, sheet 'Actual', cell N46, 807,990 as per SA Power Networks 2022-23 Pricing Model, sheet 'Actual', cell N46.

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Costs Borne by Origin

As a principle, we consider that a regulatory regime that regulates costs ought to apply the principle of the recovery of efficient costs. Arguments around the benefits of allocative efficiency are well understood. Notwithstanding, the NERL requires the RoLR to bear some of the costs when making an application for cost recovery. However, the NERL does not provide guidance on how this proportion of costs is to be calculated.

We believe a guiding principle in this regard ought to be what costs would a retailer incur in competing for a customer in a contestable retail market. We note that the Essential Services Commission (ESC) has considered this matter in its various VDO Victorian Default Offer decisions. The ESC applied a benchmark customer acquisition and retention cost allowance of $41.01 in its most recent decision that corresponded to this RoLR event. [3]

We believe applying this figure to Origin's inherited customers provides a transparent objective calculation. Applied to the 929 customers this provides for costs of $38,098 to be borne by Origin.

Financial impacts on distributors

For electricity, the National Electricity Retail Law deems any payments made to a retailer under a distributor payment determination to be a positive pass through approved under the National Electricity Rules. The first notice the AER will receive of a distributor payment determination pass through amount is at the next relevant annual pricing proposal.

This application is for $363,751. The annual revenue allowance for Endeavour Energy in the 2022-23 financial year is $1,168M; Essential Energy is $1,304M; Energex is $1,594M, and SA Power $1,251m.[4] Therefore, this application is a minor percent of annual revenue. Furthermore, an annual working capital allowance until these costs were recovered in the next available pricing year would we around $22k for all networks which would not impose any material price impacts.

Based on these figures, we do not consider the use of a distribution payment model would create a short-term funding constraint for the network.

If you have any questions, or require any additional information in respect of this matter, please contact [redacted] as follows:

Direct: [redacted]
Mobile: [redacted]
Email: [redacted]

[3] ESC, Victorian Default Offer Final Decision 2022-23, p.27.

[4] Based on revenue from Endeavour Energy 2022-23 Pricing Model and Essential Energy 2022-23 Pricing Model, sheet 'Financial', cells P102:P104; Energex 2022-23 Pricing Model and SA Power Networks 2022-23 Pricing Model, sheet 'Financial', cells O102:O104.

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Yours sincerely,

[redacted]

[redacted]

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