ESSENTIAL SERVICES COMMISSION

Victorian Default Offer from 1 January 2022

Draft decision

7 September 2021

An appropriate citation for this paper is:

Essential Services Commission 2021, Victorian Default Offer from 1 January 2022: Draft decision, 7 September

Contents

Our draft decision is that VDO prices should decrease

- Under an Order in Council (pricing order), issued under the *Electricity Industry Act 2001 (Vic)*, we must set prices for the Victorian Default Offer (VDO). [1]
- Our draft decision results in a lower VDO. The average annual bill for residential customers on the VDO would be lower by five per cent from 1 January 2022, with a seven per cent fall for small business customers. This is largely due to forecast changes in wholesale electricity prices.
- We are seeking feedback on our draft decision.

The Victorian Default Offer (VDO) was put in place by the Victorian Government on 30 May 2019 to regulate standing offer prices for electricity in Victoria.

Standing offers are contracts that electricity retailers must make available to domestic and small business customers. A standing offer will apply if the customer has:

- never signed up for an electricity contract
- entered into an electricity contract, cancelled the contract within the cooling-off period, but continues to use electricity without entering into a further contract
- moved into a new address and uses electricity without entering into a contract or
- specifically asked for a standing offer.

Although prices for standing offers are regulated, electricity retailers can and do supply electricity under market offers with prices that are different to standing offers.

We must review VDO prices

The pricing order gives us the role of determining the prices for standing offers.

On 25 November 2020, we made a determination that set VDO prices for calendar year 2021. Under the pricing order, we must make a new determination for the tariffs to apply from 1 January 2022.[2] This determination must be made by 25 November 2021.

[1] Order in Council made under section 13 of the *Electricity Industry Act 2000* and published in the Victorian Government Gazette No. S 208 on Thursday 30 May 2019. An amendment to schedule 1 was ordered in the Victorian Government Gazette, No. S 216 Tuesday 4 June 2019 (updating controlled load charges).

[2] Depending on the outcome of this consultation process the determination may apply for more or less than 12 months.

The objective of the VDO and who it applies to

The objective of the VDO is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity market.[3]

The VDO is a set of prices that applies to all types of standing offers. From 1 September 2020 the VDO also applies as a maximum price for most customers in embedded networks.[4] The VDO also acts as a reference price to help consumers compare market offers. [5]

The VDO is generally available to domestic and small business customers. Around 200,000 households and 50,000 small businesses are on standing offers. This represents seven per cent of households and 16 per cent of small business customers. VDO prices are also a price cap for roughly 140,000 customers in embedded networks. [6]

Customers may be able to get a better deal than the VDO

For most customers, the VDO will not be the best offer available. Retailers must regularly tell customers whether they are on the retailer's best energy plan, and how much the customer could save by switching. Embedded networks may also offer prices below the VDO.

Our draft decision is to keep our approach largely unchanged

At this stage, we consider that using largely the same approach as we did in our 2021 VDO price determination will best meet our legislative objectives. While we have used generally the same approach, we have updated all relevant parts of our decision with the most recent data available.

We made this draft decision after considering all matters raised by stakeholders and all relevant provisions and matters we must have regard to under the *Essential Services Commission Act 2001 (Vic)*, *Electricity Industry Act 2001 (Vic)* and the pricing order. As part of our review we published a consultation paper on 14 May. We received 16 submissions in response to the paper. We also held a public forum on 20 May to give stakeholders another way to share their views.

Our draft decision would lead to lower VDO prices

Our forecasts of the efficient costs of the sale of electricity by a retailer (efficient costs) is lower for 2022 than it was in 2021. This is mainly driven by forecast decreases in wholesale electricity costs.

---

[3] Clause 3 of the pricing order sets out the objective of the VDO.

[4] Essential Services Commission 2020, Maximum prices for embedded networks and other exempt sellers: Final Decision, 22 July.

[5] Clause 15 of the pricing order sets out how the VDO is used as a reference price.

[6] ESC, Embedded electricity network data and customer numbers, available at: https://www.esc.vic.gov.au/electricity-and-gas/licences-and-exemptions/electricity-licensing-exemptions/embedded-electricity-network-data-and-customer-numbers.

We also reviewed and updated the other elements of our cost stack (environmental costs, retail costs, network costs and other costs) with the most recent data available. We will update the data in our cost stack again when we make our final decision. This is likely to affect the forecast impact on bills.

We forecast the efficient costs for serving residential and small business customers in each of Victoria's five distribution zones. On average, across all five distribution zones, for customers on the VDO the representative residential bill will decrease by roughly five per cent (from $1,412 to $1,338) and seven per cent (from $5,686 to $5,314) for the representative small business bill.

Figure 1: Draft decision on VDO prices – estimated average residential annual bill

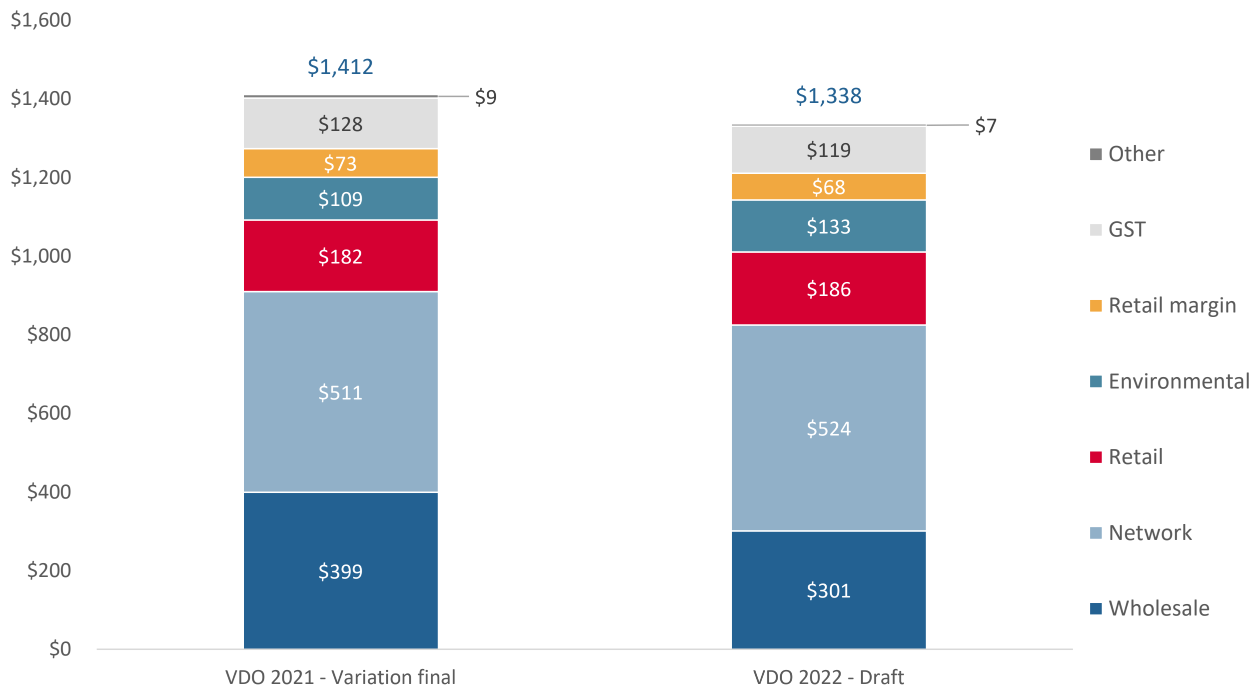
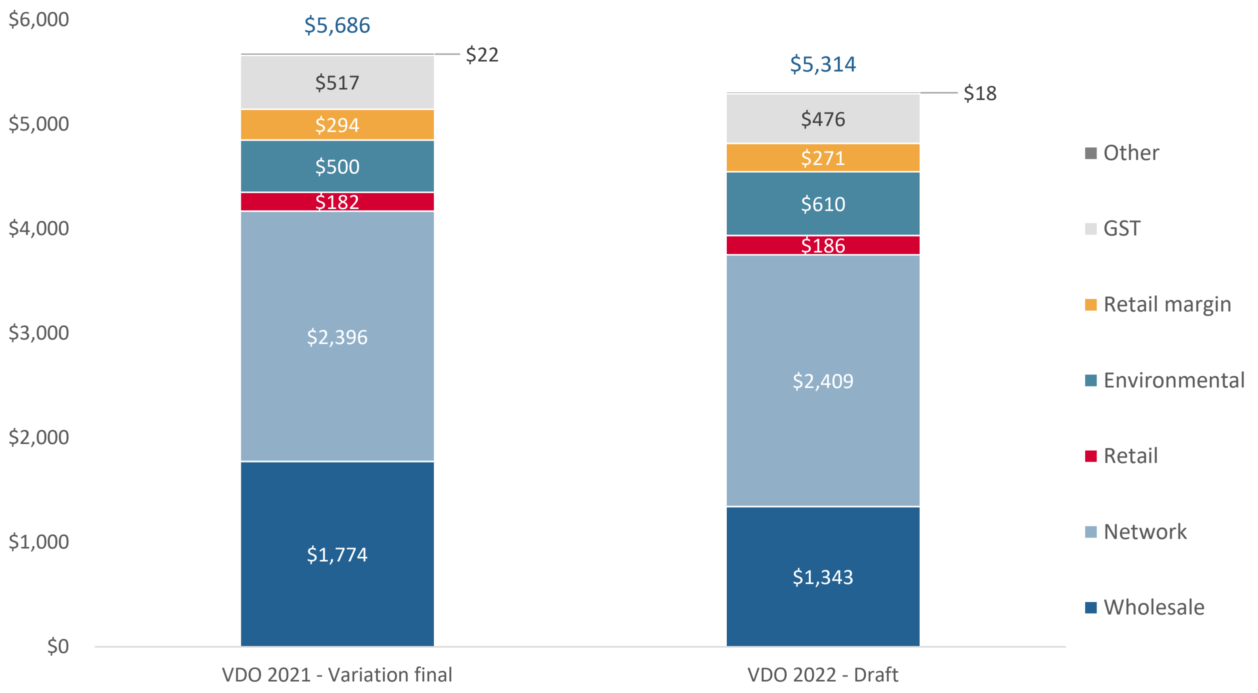


Figure 2: Draft decision on VDO prices – estimated average small business annual bill



In the absence of strong new evidence we intend to remove the temporary allowance for bad debts in our final decision

In our final decision for the 2021 VDO we included a temporary additional amount of $6 for bad debts. This adjustment was included in our retail operating cost allowance to reflect the expected impact of the coronavirus pandemic on retailers' bad debts.

For our draft decision for the 1 January 2022 VDO we have retained the temporary adjustment in our cost stack, pending our final decision. Noting current restrictions on movement in Victoria and New South Wales, in the lead up to our final decision we will monitor economic conditions, forecast bad debts and the change in the amount customers owe. This will allow us to make our final decision with the most up to date information possible.

The information currently available to us suggests that we should remove the adjustment for bad debts in our final decision. Publicly listed retailers' statements to market show the level of bad debts in 2021 has been lower than expected.[7] [8] They also show that the amount of new bad debts retailers expect to face in 2022 is lower than it was for 2021. The level of unemployment is also

---

[7] Origin Energy, 2021 Full Year Report, August 2021, p. 24.

[8] AGL, 2021 Annual Results presentation, August 2021, p. 23.

lower than it was prior to the pandemic and economic activity is recovering faster than expected.[9] [10] We also note that the level of arrears for customers that cannot pay ongoing usage has been stable since April 2021.

In the absence of any new strong evidence we intend to remove the adjustment for bad debts in our final decision.

We will account for under or over recovered network costs

In July 2021, we amended the Victorian Default Offer 2021 price determination to account for the new network tariffs the Australian Energy Regulator approved. The new network tariffs came into effect from 1 July 2021. The variation to the VDO took effect on 1 September 2021. This means that in July and August 2021 retailers' network costs were different to what was included in VDO prices. In most cases network costs were higher than the allowance in the 2021 VDO.

We propose to make an adjustment to network costs in the VDO cost stack to account for this. Our draft decision is that any under or over recovered costs should be accounted for in full over the six-month period of the VDO to apply from 1 January 2022.

On average across all distribution zones, the adjustment will increase average annual bills by around 0.9 per cent of the cost stack for residential customers ($13) and 0.2 per cent for small business customers ($13).

Our draft decision is the regulatory period will be six months

Our draft decision is for the VDO regulatory period starting 1 January 2022 to be six months. A six-month regulatory period will help us match the timing of VDO price changes with network tariffs from 1 July 2022.

In 2020 the Victorian Government passed legislation to align the regulatory periods for the Victorian network businesses with those for other jurisdictions to run on a financial year basis. The current five year regulatory period for the Victorian network businesses started on 1 July 2021.

Given the importance of network costs for having accurate VDO prices, the regulatory periods for the VDO and electricity networks should match. Our draft decision for a six-month regulatory period will be the quickest way to align VDO regulatory periods with the network periods. Stakeholders almost unanimously supported this approach.

---

[9] Australian Bureau of Statistics, labour force Australia data (reference period July 2021), 19 August 2021 https://www.abs.gov.au/statistics/labour/employment-and-unemployment/labour-force-australia/latest-release#states-and-territories.

[10] Reserve Bank of Australia, Statement on Monetary Policy –August 2021, pp. 1-5. Economic Outlook, https://www.rba.gov.au/publications/smp/2021/aug/pdf/statement-on-monetary-policy-2021-08.pdf.

We are seeking stakeholders' views

We invite stakeholders to give us feedback on this draft decision paper.

General comments and formal submissions should be made by **5 pm on 8 October 2021**. We may not be able to consider, or may not give the same weight to, submissions received after this date.

To make a submission on this paper please go to Engage Victoria's website: www.engage.vic.gov.au. Otherwise, please email us at VDO@esc.vic.gov.au to discuss other options for making a submission.

All submissions come under the commission's submissions policy. Submissions will be made available on the commission's website, except for any information that is commercially sensitive or confidential. Submissions should clearly identify which information is sensitive or confidential.

To help stakeholders plan how to take part in this review, table 1 below provides indicative timeframes for consultation on the VDO to apply from 1 January 2022.

Table 1: Timeframes for the 1 January 2022 VDO review

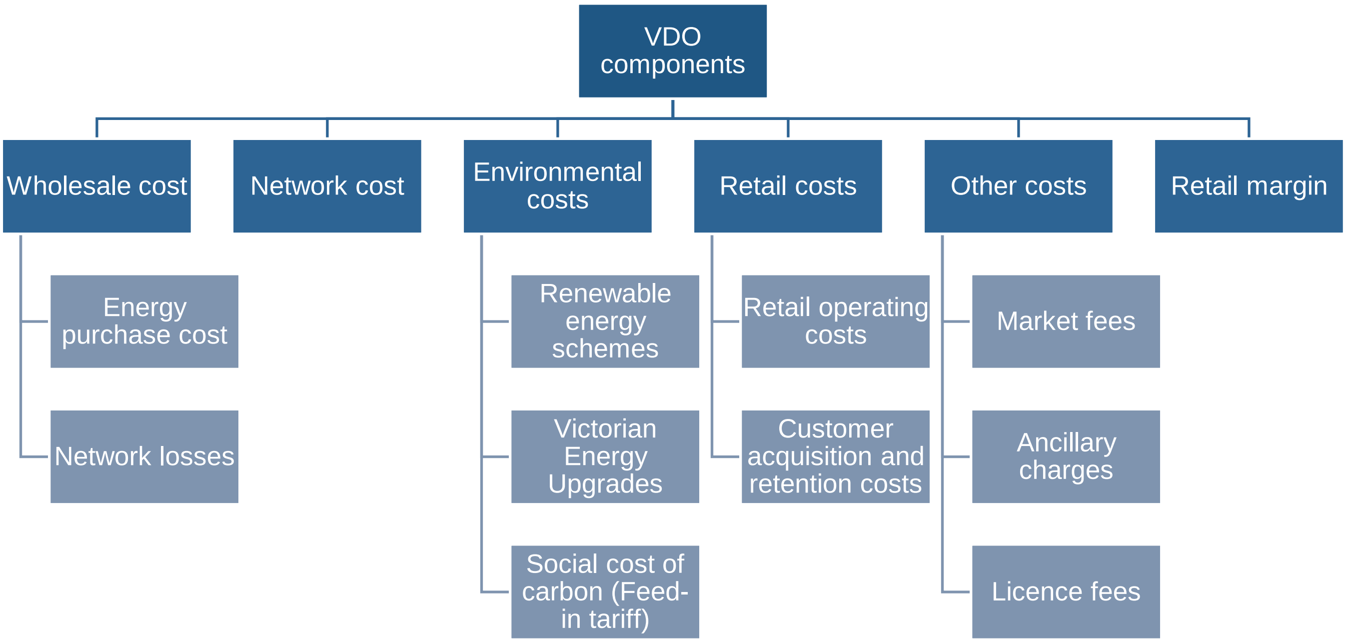
Key milestones	Indicative date
Draft decision	7 September 2021
Draft decision – public forum	23 September 2021
Submissions on draft decision close	8 October 2021
Final decision and final determination	By 25 November 2021
1 January 2022 VDO takes effect	1 January 2022

We will continue to work with consumer groups, industry, and other government bodies as part of this review, but due to the pandemic we will use online tools where possible to replace face-to-face engagement activities.

VDO cost components

In setting the Victorian Default Offer (VDO) tariffs, we assess the efficient costs of providing retail electricity services. Figure 3 sets out the key items included in the VDO cost stack.[11]

Figure 3: Cost items included in the VDO cost stack



A summary of our approaches to estimating each item that makes up the total VDO costs is as follows:

- **wholesale electricity costs** – based on the expected future electricity costs in the market, which also includes the cost of electricity lost when it is transported
- **network costs** – taken directly from tariffs approved by the Australian Energy Regulator
- **environmental costs** – using available market data on the expected future costs of meeting renewable energy schemes and the Victorian Energy Upgrades program
- **retail costs** – based on benchmarks from previous regulatory decisions
- **other costs** – taken directly from published reports from industry bodies
- **retail operating margin** – based on a benchmark from a comparable regulatory decision.

[11] Clause 12(4) of the pricing order that requires the commission to account for a particular set of costs.

As part of this review we updated the estimates included in the VDO cost stack to reflect changes in the market and new data.

In preparing this draft decision we undertook further analysis of our already established approach to determining VDO prices. For example, we reconsidered the retail margin and whether or not to include a productivity factor.

We also considered some short-term issues that may affect retailers' costs. These include the potential for increased bad debts due to the pandemic and network costs that retailers were unable to recover from consumers for the months of July and August 2021.

We are also in the process of working with retailers to verify the 2020 cost data that we collected from them. We will provide some of the insights from this data in our final decision. For our final decision we will also update benchmarks that rely on market-based data such as wholesale and environmental costs.

Wholesale electricity costs

- Our draft decision is to use forecasts of wholesale electricity prices based on futures prices from ASX Energy. This was our approach in the 2021 VDO price determination.
- Wholesale electricity purchase costs make up around 22 per cent of an annual residential bill (averaged across the five distribution zones).
- Wholesale electricity costs in our draft decision are 25 per cent lower than those in the 2021 cost stack for residential users.

We forecast energy purchase costs will be lower

Energy purchase costs are incurred by retailers when they purchase electricity from the wholesale market to meet the demand of their customers. The pricing order requires us to have regard to the efficient costs of providing retail electricity services, including wholesale electricity purchase costs.[12] We have used a futures market approach to estimate a benchmark energy purchase cost allowance for 2022. The futures market approach is based on an estimate of the costs that a retailer would face in supplying electricity to their customers using financial hedging products purchased on ASX Energy. We used this approach in making our determination on the 2021 VDO.

[12] Clauses 12(3) and 12(4) of the order.

This approach is also consistent with the approach taken by other Australian regulators.[13] Our draft decision forecast is lower than the allowance provided in 2021.

Energy purchase costs

Electricity generators supply wholesale electricity to the National Electricity Market which matches generation with demand in real time. Electricity retailers must secure a supply of wholesale electricity, and while some retailers own generators, many buy electricity directly from generators on the spot market. Buying electricity from the spot market exposes retailers to the risk that electricity prices may be high when they need to purchase electricity. Hedging is a way of managing this risk. If a retailer hedges its wholesale electricity risk, the price it pays for electricity is set in advance or capped. Retailers can hedge by either contracting directly with a generator, or through a financial market such as ASX Energy.

Futures prices are transparent as they are publicly traded. Also, anyone can access contracts available through ASX energy. In basing our estimate on the futures market, our approach reflects market outcomes and efficient costs.

Frontier Economics estimated wholesale electricity purchase costs

We engaged Frontier Economics to estimate wholesale electricity purchase costs. We have considered their approach and accept Frontier Economics' recommendations as reflecting a benchmark of efficient wholesale electricity purchase costs for the purpose of estimating VDO prices. A full description of Frontier Economics' methodology, including data sources, is included in its report.[14] A summary is provided below.

Frontier Economics determined the relationship between load and spot prices using five years of historical data 2016–17, 2017–18, 2018–19, 2019–20 and 2020–21. Half-hourly customer load data was provided to us by the Australian Energy Market Operator (market operator). Victorian half-hourly spot prices for the same period were sourced from the market operator's publicly available data. Frontier Economics performed a Monte Carlo simulation using historical data on load and price.

The simulation randomly generates a year of half-hourly observations. This process is repeated 500 times to generate a range of simulated years.[15] Each simulated year is normalised in order to

---

[13] Other regulators including the Queensland Competition Authority, the Independent Competition and Regulatory Commission (in the ACT) and the Australian Energy Regulator have used a futures approach to forecast wholesale electricity costs.

[14] Frontier Economics, Wholesale electricity costs for 2022 – a draft report for the Essential Services Commission, August 2021.

[15] The random drawing of data is done from a pool of like days, where days are classified as either weekdays or weekends, from either Q1 (January to March), Q2 (April to June), Q3 (July to September) and Q4 (October to December).

maintain load shape and the correlation between load and price. Each simulation is then scaled to half-hourly prices so that the time-weighted average prices in each quarter equal the relevant quarterly ASX Energy base swap price for 2021, subtracting a contract premium.[16]

It then estimated the cost of hedging, as well as the hedging position a prudent retailer would likely adopt. To estimate the cost of financial hedging, 12-month trade-weighted hedging contract prices on quarterly electricity derivative contracts were used; base and peak swaps, and base $300 caps. An efficient contracting position was then estimated using Frontier Economics' STRIKE model. An amount for holding working capital (cash) to fund spot market purchases was also included – a volatility allowance which funds shortfalls during periods of very high spot prices.

We considered the length of the regulatory period on wholesale costs

Our draft decision maintains our approach to calculating wholesale costs. Our view is that using the 12-month average wholesale cost balances customer and retailer interests and maintains consistency with our approach in previous reviews.[17]

Our understanding is that retailers take on different hedging strategies. Retailers can hedge their wholesale risk for longer or shorter periods. Some only hedge a matter of months in advance. Others hedge years in advance. We consider that a 12-month trade-weighted average provides a reasonable benchmark amongst the range of approaches that could be taken by retailers.

Further, given the seasonality of wholesale prices, if we were to change our approach now, after using a 12-month average for the second half of 2019, it could lead to VDO prices being above long-run efficient costs. This would not be in the long term interests of Victorian consumers.

We considered changes to wholesale cap contracts

Our draft decision uses the data from the listed cap contracts (designed for five-minute settlement). These contracts were introduced to replace the existing cap contracts in March 2021 as base $300 cap contracts (which can be purchased up to four years in advance) will no longer be available from ASX Energy. This was due to the market operator's rule change on five-minute settlement in the National Electricity Market.

We consider the use of recently listed cap contracts is transparent and consistent with the market approach used by Frontier. This approach was also supported by stakeholders.[18]

---

[16] The assumed contract premium is five per cent on the underlying prices.

[17] Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, May.

[18] Origin Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2.

We factored network losses into our draft decision

When electricity is transported through transmission and distribution networks, some of it is lost in the process. Electrical losses occur because of electrical resistance in the wires, converting some electricity to heat. These losses must be factored into any electricity purchased through the wholesale market to ensure supply meets demand. As a result, more electricity is generated than is consumed by end users.

In calculating network loss factors, we determine how to account for marginal (energy losses for electricity transmitted on a transmission network) and distribution (energy losses for electricity transmitted on a distribution network) loss factors.

Our draft decision for distribution loss factors is to use the short sub-transmission factor for the CitiPower, Jemena, and United Energy distribution zones and the average of the short and long sub-transmission factors for the Powercor and Ausnet zones.[19] For marginal loss factors, we take a simple average of the relevant regional reference node factors for each distribution zone.[20] We combine these to calculate an adjustment factor which is applied to energy purchase costs, environmental costs, and ancillary charges.

Distribution loss factors

In our previous decision we stated our analysis on distribution loss factors showed that using the short sub transmission loss factor may slightly undercompensate retailers for providing services to customers in the Ausnet and Powercor distribution zones. To address this, in those distribution zones we used the simple average of the short and long sub-transmission distribution loss factors and noted we would investigate a more accurate measure for distribution loss factors in those distribution areas as part of our next review.[21]

In our consultation paper we again noted our intention to investigate the use of a weighted average approach to calculating distribution loss factors to apply to both Ausnet and Powercor regions should this approach better reflect the losses incurred in servicing customers in rural areas.[22] As part of this review we sought further information from electricity distributors on aggregate load data and total customer numbers attributable to short and long transmission lines for customers using up to 40MWh. Our analysis found both approaches produced similar results with a less than half a per cent difference in customers annual bills. We have therefore kept our approach of using the

---

[19] Australian Energy Market Operator, Distribution Loss Factors for the 2021-22 Financial Year, July 2021, p. 13.

[20] Australian Energy Market Operator, Marginal Loss Factors for the 2021-22 Financial Year, July 2021, pp. 24-29.

[21] Essential Services Commission 2020, Victorian Default Offer 2021: Final decision, 25 November, pp. 16-17.

[22] Essential Services Commission 2021, Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 14 May, p. 27.

simple average of the short and long sub-transmission distribution loss factors as it is more transparent and easily replicable.

Marginal loss factors

Marginal loss factors represent the marginal increase (or decrease) in electricity lost when transporting energy between a generator and a new end user in a given area. In calculating the marginal loss factor, we take a simple average of the relevant regional reference node factor for each distribution zone.

Our view is that a simple average approach to marginal loss factors best meets the objectives of the pricing order. A simple average is more transparent and easily replicable than the use of a weighted average approach. Using a weighted average approach, it would be difficult to separate the impact of large industrial users on marginal loss factors. Given these limitations, a simple average of the data set is more appropriate in setting prices for VDO customers (that is customers with usage up to 40 MWh per annum).

We considered matters raised by stakeholders

In response to our consultation paper, stakeholders generally continued to support our overall approach to estimating wholesale electricity costs. Several submissions, however, raised concerns about the estimation of wholesale electricity costs for a six-month regulatory period. Some stakeholders proposed changes to Frontier Economics' approach to calculating wholesale electricity costs.[23] Another submission raised concerns that Frontier Economics' approach in calculating wholesale costs risks over-estimating the cost of wholesale energy.[24]

Some of the issues raised in response to our consultation paper have been considered in previous reviews. Origin Energy did not support setting wholesale electricity costs based on the median (50th percentile) of simulated years and directed the commission to arguments put forward in their

[23] EnergyAustralia, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 2-3; AGL, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 1-4; Origin Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2; Powershop/MEA group, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021,p. 2; AEC, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 2-3.

[24] CALC, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 5.

previous submissions.[25] We note this issue has previously been considered in our 2021[26] and 2020[27] VDO decisions and the evidence available to us on the issue has not changed.

While our approach is well established, we continue to consider matters raised by stakeholders. We are open to any new information that leads to our methodology better meeting our regulatory objectives.

Length of the regulatory period

EnergyAustralia, AGL, Origin Energy, Alinta Energy, Powershop and the Australian Energy Council note concern that using an annual forecast for wholesale energy costs in the 1 January 2022 VDO would underestimate retailers' costs for a six-month regulatory period running over the first half of the calendar year.[28] Wholesale prices tend to be higher in the first half of the calendar year. This means a six-month weighted average wholesale price for the first half of 2022 would be higher than the average for the whole of 2022.

Our view is that it is appropriate to calculate the level of future prices based on forecast wholesale prices for a whole year. This is consistent with our understanding that retailers would generally set prices expecting to serve customers for more than six months. We used this approach in making our determination on the 2021 and 2020 VDO, as well as our final advice to government on the 2019 VDO.[29]

In 2019 the government accepted our advice on the level of future prices for a six-month regulatory period (1 July 2019 to 31 December 2019). Our final advice in 2019 used contract prices published by ASX Energy for a 12-month period. We did not consider it was reasonable to estimate wholesale purchase costs only for the six-month period. This would have understated the cost for a

---

[25] Origin Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2.

[26] Essential Services Commission 2020, Victorian Default Offer 2021: Final decision, 25 November, p. 16.

[27] Essential Services Commission 2019, Victorian Default Offer to apply from 1 January 2020: Final decision, 18 November, pp. 24-25.

[28] EnergyAustralia, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 2-3; AGL, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 1-4; Origin Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2; Alinta Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1; Powershop/MEA group, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2; AEC, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021,pp. 2-3.

[29] Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, 3 May, pp. 25 – 26.

retailer to serve customers.[30] As discussed we have used a 12-month trade-weighted average benchmark to reflect retailers' practice for hedging wholesale costs.

A consistent approach across regulatory periods provides a better outcome for VDO customers who benefit from more efficient prices. Should we take a new approach now this would mean retailers would recover more than efficient costs.

EnergyAustralia agrees with us that retailers usually set prices considering a period longer than six months. However, it considers there are unique circumstances for this regulatory period. EnergyAustralia submits:[31]

> In parallel with the ESC moving to a financial year VDO to align with network tariffs, retailers may also be adjusting their own pricing practices from calendar year to financial year. In our experience, pricing decisions are not made in isolation of VDO determinations. If the VDO is set on a six-month basis then it is reasonable for retailers to align Market Offer tariffs with that shorter timeframe.

Retailers' pricing decisions for market offers are individual business decisions and should be made on the basis of market expectations of changes in underlying costs. It is not clear to us how our decision on VDO prices would change retailers' underlying wholesale costs.

EnergyAustralia's supplementary submission also states that using the 12-month weighted average price could affect retailers' financial viability. [32] In addition to the fact that we consider our approach allows retailers to recover efficient costs we also note that standing offers cover a very small share of total customers for most retailers. Most retailers' customers and revenues come from market offers.

Contract prices are a good proxy for wholesale prices

The Consumer Action Law Centre suggests that we should incorporate approaches that ensure the wholesale prices we set line up with actual costs faced by retailers – noting the Australian Competition and Consumer Commission's monitoring of spot prices has shown significantly lower prices over the past year. The Consumer Action Law Centre states:

---

[30] Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, 3 May, p. 25.

[31] EnergyAustralia, supplementary submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, August 2021, p. 3.

[32] EnergyAustralia, supplementary submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, August 2021, pp. 1-4.

> We would like to see other approaches explored by the Commission to calculate wholesale costs including strategies of vertical integration and power purchase agreements used by retailers. The current approach risks over-estimating the cost of wholesale energy. [33]

The Consumer Action Law Centre submits cost estimates based on ASX Energy contracts should be treated as an upper bound for hedging costs, not an 'efficient' estimate. The Consumer Action Law Centre recommends we check modelled wholesale costs against the actual range of wholesale and hedging costs paid by all retailers.

We acknowledge that our wholesale cost forecasts could potentially be lower if we used a different methodology that included other non-market approaches to hedging. However, there are a number of benefits of using our approach over other approaches.

Using contracts traded on ASX Energy does not require a retailer to be a certain size or structure – any retailer should be able to hedge its exposure to wholesale spot prices using this approach. Some retailers may not be able to use other strategies such as building generation plants or entering into power purchase agreements.

Using futures contracts is also forward looking, meaning it looks to market expectations of what prices will be in the upcoming regulatory period. This is consistent with how we understand retailers hedge to meet the demand for electricity from their customers.

Our approach is also more transparent than other methods. In developing a benchmark for wholesale electricity purchases, we use contract prices that are likely to reflect the market's view about future prices for 2022. That is ASX Energy base and peak swaps, and base $300 caps prices which are published for each contract and each trading day. These publicly traded contracts are transparent and accessible.

We also note that we have compared our benchmarks to the cost data submitted to us by retailers. Our wholesale benchmarks sit within the range of costs actually incurred by retailers.

Accounting for marginal loss factors

Origin Energy agrees with the commission's proposal to retain the current approach.[34] On the other hand, EnergyAustralia asks the commission to consider a weighted average instead of a simple average approach to calculating marginal loss factors. EnergyAustralia submits differences in

[33] CALC, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 5.

[34] Origin Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3.

marginal loss factors can result in material differences for retailers in recovering costs and has offered to provide updated data and calculations to inform this issue.[35]

As mentioned above our view is that a simple average approach to marginal loss factors best meets the objectives of the pricing order. This approach is more transparent and easily replicable than the use of a weighted average approach. There are also limitations in applying a weighted average approach to small users due to the impact of large industrial users on marginal loss factors.

Wholesale prices for the two-period time of use VDO

In July 2021 the Australian Energy Regulator approved changes to the structure of network tariffs. This included simplifying existing time of use tariffs by replacing them with a new two-period (peak and off-peak) time of use tariff. In July we also amended the VDO to include a new two-period time of use VDO to align with the new network tariffs. Our draft decision is to calculate the tariffs for the two-period time of use VDO using the average wholesale costs rather than having separate wholesale costs for the peak and off periods.

We propose to use this approach as it allows retailers recover their efficient costs and retailers do not hedge separately for customers on different tariffs.

EnergyAustralia acknowledges that our proposed approach is appropriate in the short term but encourages the commission to consider using a different approach in the medium term. EnergyAustralia submits adopting different energy cost components for the peak and off-peak periods would provide a more effective and stronger price signal to customers.[36] The Consumer Action Law Centre also encourages the commission to monitor whether separate wholesale costs for peak and off-peak periods may be required in future as the continued introduction of solar and battery storage into the grid has the potential to drive wholesale prices lower.[37]

We note stakeholder comments on this matter and may reconsider our approach in future. In particular we would be interested in evidence that VDO customers are able to engage with price signals.

---

[35] EnergyAustralia, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3.

[36] EnergyAustralia, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 3-4.

[37] Consumer Action Law Centre, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 7.

Network costs

- Our draft decision is to keep using a cost pass through approach for network costs.
- For our draft decision on these network costs, we have used the network tariffs approved by the Australian Energy Regulator for the 2021–22 financial year.
- Network costs represent about 38 per cent of the average residential bill (averaged across the five distribution zones).

Network costs represent the costs of building, operating and expanding the electricity distribution and transmission networks. We are required to have regard to network costs in estimating efficient costs.[38]

There are five electricity distribution networks operating in five separate zones across Victoria, each with their own maintenance needs and growth rates. The charges for each network are approved by the Australian Energy Regulator on an annual basis.

For all domestic and small business electricity customers, there are three main elements associated with each network tariff:

- distribution charges – for the use of the distribution network
- transmission charges – for the use of the transmission network
- jurisdictional charges – for the payments distributors are required to make.

Our draft decision is to keep our approach to network tariffs

We propose to keep our past approach for calculating network costs. This is a cost pass through approach using the network tariffs approved by the Australian Energy Regulator for each distribution zone (see appendix A). This is supported by stakeholders.[39]

Network costs are generally made up of:

- a daily supply charge and a flat usage charge (flat network tariffs) or

---

[38] Clauses 12(4)(b) of the order.

[39] Alinta Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 16 June 2021, p. 2; Origin Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 16 June 2021, p. 3; Momentum Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 16 June 2021, pp.3-4; Simply Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 15 June 2021, p.3.

- a daily supply charge and peak usage and off-peak usage charge (two-period time of use network tariffs).[40]

We also include metering charges for each distribution zone, and a controlled load option for domestic customers where applicable. For our draft decision on these network costs, we have used the tariffs approved by the Australian Energy Regulator for the 2021–22 financial year.

Under or over recovered network costs for July and August 2021

- Our draft decision lets retailers recover under or over recovered network costs from July and August 2021 in the first half of 2022.
- We propose the amount to be recovered be based on actual usage for the months of July and August 2021.
- We propose any under or over recovery of network costs should be added to the daily supply charge for all standing offer customers (except for controlled load usage).

Network costs are treated as a pass through in the VDO methodology. They are costs incurred by retailers in providing retail services with the tariffs approved by the Australian Energy Regulator.

We amended the 2021 VDO price determination to account for the new Australian Energy Regulator approved network costs applying from 1 July 2021. Our final decision on the variation took effect on 1 September 2021. The effective date for the variation of 1 September means that retailers' costs will not match with the VDO prices for the months of July and August 2021. There was a difference between the network costs included in VDO prices and actual network costs for the period between 1 July and 31 August 2021.

In our draft decision paper on the variation, we sought feedback from stakeholders on how we might account for the difference between revenues and costs for network services over this two-month period.[41] In general, stakeholders preferred the recovery to be done as soon as possible, and that the amount to be recovered be based on actual usage for the months of July and August 2021.[42] Our final decision on the variation was to include any under or over recovered network costs in the 1 January 2022 VDO.[43] In making that decision, we took into account customer

[40] We introduced a two-period time of use tariff VDO when we amended the 2021 VDO price determination in July 2021.

[41] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Draft decision, June 2021, pp. 13–14.

[42] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, pp. 16–18.

[43] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, pp. 15–18.

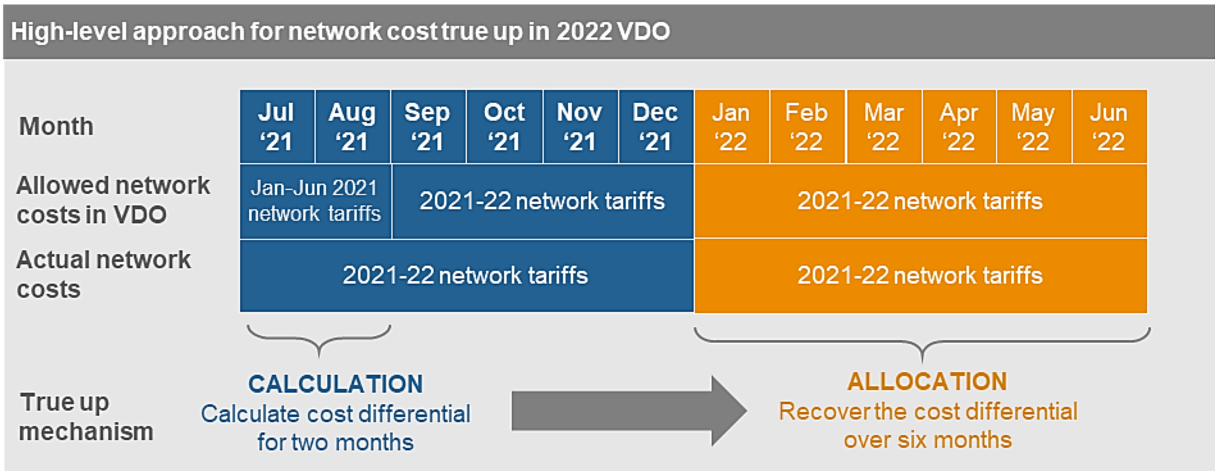
impacts, any operational disruptions our decision might create and different stakeholder views on how to account for the network cost differentials.[44]

Consistent with our final decision for the variation, we propose to include under or over recovered network costs in the 1 January 2022 VDO, which we propose will be a six-month regulatory period. These costs are not immaterial, and retailers should be able to recover them as soon as it is practical to do so, that is from 1 January to 30 June 2022.

Any under or over recovery will be based on actual usage

We propose to estimate the amount of under or over recovered costs for July and August 2021 based on actual electricity usage for those two months. This means that any under or over recovered network costs are more cost reflective. Our proposed approach addresses retailer concerns that under or over recovered costs for the months of July and August 2021 should be based on actual usage.[45] Figure 4 shows that we will calculate the difference in network costs for July and August 2021 and allocate this difference to VDO prices for the first half of 2022. See appendix B for more details about calculation and allocation.

Figure 4: High-level approach for network cost true up in the 1 January 2022 VDO



For our draft decision, we have used the Australian Energy Market Operator's usage data for July and August 2020, as 2021 data is not yet available. However, we propose to update our estimate of under or over recovered network costs with actual usage for the period 1 July to 31 August 2021 when we make our final decision.[46]

---

[44] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, pp. 15–16.

[45] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, p. 18.

[46] Usage data for July and August 2021 should be available from the Australian Energy Market Operator at the end of September 2021.

Tables 2 and 3 show the estimated cost impact for each distribution zone and customer type.

Table 2: Flat tariff customers – estimated under or over recovered network costs: July–August 2021, on average per distribution zone, $ per customer incl GST

Distribution zone	Domestic customers	Small business customers
AusNet Services	$12.38	$23.45
Citipower	$16.96	$8.14
Jemena	$14.70	$23.83
Powercor	$14.77	$10.44
United Energy	$6.51	$0.05
Victoria (average)	$13.06	$13.18

Notes: Based on the difference between the network charges in the original and amended 2021 VDO determinations. Under recovery is in positive dollars. Over recovery is in negative dollars. See appendix B for details.

Table 3: Two-period time of use VDO tariffs – estimated under or over recovered network costs: July–August 2021, on average per distribution zone, $ per customer incl GST

Distribution zone	Domestic customers	Small business customers
AusNet Services	-$6.76	-$49.51
Citipower	$15.54	$3.14
Jemena	-$3.88	$11.56
Powercor	$11.78	$4.97
United Energy	$4.98	-$4.85
Victoria (average)	$4.33	-$6.94

Notes: Based on the difference between the network charges in the original and amended 2021 VDO determinations. Under recovery is in positive dollars. Over recovery is in negative dollars. See appendix B for details.

We propose recovery through the daily supply charge

We propose that the amount to be recovered by retailers will be added only to the daily supply charge, except for controlled load usage charges. This will be more accurate than relying on assumptions about what customer usage will be for the first half of 2022. Electricity usage may vary for customers over the six months from the representative domestic and small business consumption, leading to either more or less network costs recovered from customers.

This approach assumes that customer numbers will stay roughly unchanged. We have observed that over the last twelve months total customer numbers have remained reasonably stable. We will continue to monitor changes in customer numbers between now and our final decision.

For under or over recovered network costs on controlled load usage, we propose that the amount be recovered through the controlled load usage rate. Only some standing offer customers incur these costs, so they cannot be added into the daily charge applied to all standing offer customers.

Environmental costs

- Our draft decision is to continue to use the approach to estimating environmental costs that we used in our final decision on the 2021 VDO.
- Environmental costs represent about nine per cent of the average residential bill (averaged across the five distribution zones).
- Our draft decision means the dollar value of environmental costs in the cost stack will increase. This is mainly driven by increases in costs associated with the Victorian Energy Upgrades scheme.

Under the pricing order, we are required to have regard to environmental costs.[47] There are four main environmental costs faced by Victorian electricity retailers:

- Large-scale Renewable Energy Target
- Small-scale Renewable Energy Scheme
- Victorian Energy Upgrades and
- The social cost of carbon applied to the minimum feed-in tariff.

Our draft decision allowance for environmental costs is higher than the allowance included in the 2021 VDO. In the average annual bill for residential and small business customers, the allowance for environmental costs has increased by around 22 per cent. This is largely because of changes to the Victorian energy efficiency certificate prices used to calculate Victorian Energy Upgrades costs.

Our draft decision is to keep our approach to calculating environmental costs

Our draft decision on how to calculate these components of the VDO is as follows:

- Small-scale Renewable Energy Scheme – the small-scale technology percentage will be multiplied by the clearing house price

[47] Clause 12(4)(c) of the order.

- Large-scale Renewable Energy Target – the 2022 default renewable power percentage will be multiplied by the futures market price for large-scale certificates
- Victorian Energy Upgrades – the 2022 greenhouse reduction rate for electricity will be multiplied by the historic 12–month average price for Victorian Energy Efficiency Certificates.
- The above costs will be multiplied by network loss factors
- Minimum feed-in tariff (social costs of carbon) – total renewable exports in 2020–21 will be divided by average total domestic and small business customers in 2020–21, multiplied by the social cost of carbon (2.5 cents).

We have kept our approach to the Small-scale Renewable Energy Scheme

The Small-scale Renewable Energy Scheme places an obligation on retailers to purchase small-scale technology certificates. The Clean Energy Regulator sets small-scale technology percentage every year which sets the amount of small-scale technology certificates retailers must buy.

Our draft decision is to use the same approach to calculating the cost of the small-scale renewable energy scheme as in previous VDO decisions. We use the mid-point of the 2022 non-binding small-scale technology percentage and the 2021 binding small-scale technology percentage, multiplied by the clearing house price. We have included an allowance to account for the discrepancy between the level of the non-binding small-scale technology percentage we used in the 2021 VDO and the binding small-scale technology percentage for 2021.

The binding small-scale technology percentage in 2021 was higher than in 2020 as a result of strong growth in rooftop solar uptake.[48] However, the Clean Energy Regulator has set a lower non-binding small-scale percentage for 2022. This has led to a decrease in small-scale renewable energy scheme costs. There were no stakeholder submissions to our consultation paper about our approach to estimating costs for the Small-scale Renewable Energy Scheme and we consider our methodology transparent and reliable.

We have kept our approach to the Large Scale Renewable Energy Target allowance

The Large-Scale Renewable Energy Target is a Federal Government policy designed to reduce emissions in the electricity sector and encourage additional generation from sustainable and renewable sources. It creates financial incentive for the installation of renewable energy power stations.

Under the Large-Scale Renewable Energy Target, eligible renewable power stations create large-scale generation certificates for every megawatt hour of power they generate. Electricity retailers buy large scale generation certificates to meet their legally binding renewable energy obligations.

[48] Clean Energy Regulator, Quarterly Carbon Market Report – March Quarter 2021, p. 33.

Electricity retailers then surrender these certificates to the Clean Energy Regulator based on the renewable power percentage the regulator sets each year.

Our draft decision is to keep our approach to calculating the cost of complying with the Large-Scale Renewable Energy Target. Our approach will use the 2022 default renewable power percentage multiplied by the futures market price for large-scale certificates to estimate the costs retailers incur to comply. To meet their obligations, retailers buy large-scale generation certificates from the futures market or enter into power purchase agreements. As such, our approach to calculating Large-Scale Renewable Energy target costs using future market prices for large scale generation certificates provides a transparent estimate of the efficient costs of complying with the Large-Scale Renewable Energy Target.

In response to our consultation paper, we received two submissions expressing a position on our approach to estimating the costs of compliance with the Large-Scale Renewable Energy Target. Momentum Energy supported our current methodology.[49] EnergyAustralia disagreed with our approach to estimating the price of large-scale generation certificates.[50] However, it supported us continuing to monitor market prices for certificates and cross checking these prices with retailers' costs to see whether our approach is still appropriate.

We have kept our approach to calculating Victorian Energy Upgrades costs

The Victorian Energy Upgrades program is a Victorian government policy aimed at encouraging investment, employment and innovation in energy efficient products and services. Under the Victorian Energy Upgrades program, accredited persons carry out upgrade activities by installing energy-efficient products to generate Victorian energy efficiency certificates. Large energy retailers must acquire and surrender these certificates to meet annual targets set in Victorian legislation.

Our draft decision is to maintain our approach to calculating the cost of complying with the Victorian Energy Upgrades program. Our approach will use the 2021 greenhouse gas reduction rate for electricity, multiplied by the historic 12-month average price for Victorian energy efficiency certificates. We will use the 2022 reduction rate for electricity in our final decision if it is available in time. We will also update the data used to calculate the weighted average price for Victorian energy efficiency certificates when we make our final decision.

---

[49] Momentum Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3.

[50] EnergyAustralia, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 4.

Tango Energy submitted that the price of Victorian energy efficiency certificates was much higher than the average certificate price used for the previous VDO decision.[51] EnergyAustralia's supplementary submission suggested that there should be a temporary adjustment included in the Victorian Energy Upgrades costs to account for increases in the certificate prices over the last six months. EnergyAustralia stated that the upwards adjustment would reflect the higher costs for 2021. The adjustment could then be adjusted via a true up in the subsequent VDO to reflect actual historical costs for the 2021 period.[52]

We acknowledge that recent changes to the Victorian Energy Upgrades program have increased certificate prices. However, there is still some uncertainty about changes to the program and how that will affect certificate prices.

Our current approach accounts for changes in certificate prices. We use the weighted average price for certificates over the last 12 months to forecast prices for the next year. In some years, the prices from the last year will be higher than prices in the next year. In other years, prices will be lower than prices in the next.

In our draft decision we have used a certificate price of $49 for our draft decision, in our final decision we will update the certificate price with the most recent data available. If we use this approach in our final decision we expect that the certificate price we use in our final decision will be closer to current certificate prices.

We also understand that retailers can enter into contracts with accredited persons that extend into the future for certificates at a set price and hedge their risks by purchasing certificates in advance. This means that, to the extent that the certificate prices in the VDO are lower than market prices, not all certificates required in 2022 will have been bought at the higher price.

Furthermore, as the price of Victorian energy efficiency certificates are traded in an open market, and there are options for retailers to hedge their price risk, a true-up may not be appropriate. A true-up could place the price risk on consumers instead of retailers who are better able to manage the risk.

However, given the uncertainty about the impact of changes in the Victorian energy upgrades program we are open to considering other ways to forecast certificate prices.

[51] Tango Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1-2.

[52] EnergyAustralia, supplementary submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, August 2021, p. 4.

We have kept our approach to the cost of the minimum feed-in tariff

The minimum feed-in tariff is the rate that energy retailers must pay solar customers for electricity exported to the grid. This feed-in tariff includes the social cost of carbon. The social cost of carbon is the value of lowering carbon emissions when energy is sourced from small-scale renewable generators. The Victorian Government set the social cost of carbon at 2.5 cents per kWh.[53] When small-scale renewable generators export energy into the grid retailers must pay them the social cost of carbon on top of the wholesale price of electricity. This is the cost of the minimum feed-in tariff that we account for in the VDO.

Our draft decision is to maintain our current approach to calculating the cost associated with the minimum feed-in tariff. To estimate the cost to retailers, we use the total renewable exports in 2020–21 divided by average total domestic and small business customers in 2020–21, multiplied by the social cost of carbon (2.5 cents).

This approach is transparent and easily replicable. It also allows retailers to recover the efficient costs of paying for solar exports.

For this review, we have not received any stakeholder submissions on the cost of the minimum feed-in tariff.

Retail operating costs

- Our approach is to continue to use a benchmarking approach to set retail operating costs. This is consistent with the approach used in our final decision on the 2021 VDO.
- Retail operating costs represent about 11 per cent of costs in the average residential bill (averaged across the five distribution zones).
- The retail operating costs in our draft decision are higher than the amount included in our 2021 determination.
- The temporary bad debt allowance provided in 2021 may not be required in 2022 and we seek further evidence from stakeholders to demonstrate the need, or lack thereof, for the adjustment.

Retail operating costs reflect a range of costs incurred by an electricity retailer in conducting its business, this includes billing and revenue collection systems, information technology systems, call

[53] Victorian Government 2017, Victoria Government Gazette No. S 36, Tuesday 21 February 2017, Order specifying a methodology and factors for the determination of the avoided social cost of carbon.

centre costs, corporate overheads, energy trading costs, provision for bad and doubtful debts and regulatory compliance costs.[54]

Our draft decision is to use a benchmark approach to retail operating costs

The 2022 allowance for retail operating costs per customer is based on the benchmark of $121.07 set by the Independent Competition and Regulatory Commission in its 2017 final decision for retail electricity prices in the Australian Capital Territory. Consistent with the approach taken in previous reviews, we adjusted this benchmark for the change in the consumer price index (CPI) since 2017 which leads to an annual benchmark of $129.93.

In addition to this benchmark, we have set an annual allowance for additional regulatory costs and Victoria specific operating costs of $10. This allowance reflects the costs related to operating in Victoria that are not covered by the Independent Competition and Regulatory Commission benchmark, including those associated with the Payment Difficulty Framework.[55] Our draft decision also continues to include a small annual allowance of $0.84 for the ongoing operating expenditure associated with five-minute settlement. Our draft decision includes the temporary allowance provided in 2021 to account for the effect of the pandemic on bad debts, however we will monitor market conditions and remove it in the final decision if needed.

Our draft decision annual benchmark of $146.77 per customer is higher than the current (2021 VDO) benchmark of $143.30.

The benchmark approach is transparent and based on efficient costs

The benchmark approach to calculating an allowance for retail operating costs represents a transparent and simple approach. It is easily replicable and based on public information. This is consistent with the methodology we used in the VDO for 2021 and has been adopted for regulated prices in Queensland and Tasmania.

On the benchmark level, consumer groups voiced concern about additional items being added to the cost stack in VDO reviews.[56] Retailers on the other hand claimed new regulatory obligations

[54] Clause 12(4)(d) of the order requires we have regard to retail operating costs, including modest customer acquisition and retention costs, as an element in developing the efficient costs of the sale of electricity by a retailer. We address customer acquisition and retention costs in the next section.

[55] Based on the analysis of Victorian specific costs in the Australian Competition Consumer Commission's Retail Electricity Pricing Inquiry final report completed in our final advice to government. For more detail see Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, 3 May, p. 64.

[56] CALC, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 3-4.

were leading to increased costs.[57] While there have been some changes leading to higher retail operating costs, such as the transition to five-minute settlement, publicly listed retailers have also reported finding significant efficiencies leading to lower operating costs.[58]

The level of this benchmark is appropriate because it has been updated for inflation and we have cross checked our approach with actual data provided by Victorian retailers.[59] Analysis of the cost data we have collected from retailers suggests the allowance we have set represents an efficient allowance for retail operating costs for retailers of different sizes.

The temporary bad debt allowance may not be required in 2022

Bad debts occur when customers cannot pay their electricity bills. Retailers may be able to recover some of these costs from customers, but some customers may never pay their debts. In determining efficient retail operating costs for 2021 we included a temporary upward adjustment of $6 per customer to account for the effect of the coronavirus pandemic on bad debts. The allowance was based on:

- Confidential data provided by retailers – showing an increase in bad debts for 2020.
- Publicly available information – financial statements issued by Origin Energy, AGL and Red and Lumo Energy, which estimated an increase in bad debt liabilities in 2021.[60]
- Information collected from Victorian retailers on average arrears for residential and small business customers during the pandemic.
- Economic forecasts indicating subdued economic conditions in 2021.[61]

---

[57] AEC, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 1-2; Momentum Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp.1-2; EnergyAustralia, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 4-5; Origin Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 1-2; Alinta Energy, p. 2; Tango Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3; Powershop MEA group, pp. 1-2; Red and Lumo Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 1-3.

[58] Origin Energy, 2021 Full Year Results Year ended 30 June 2021: investor presentation, p. 5, August 2021 https://www.originenergy.com.au/content/dam/origin/about/investors-media/presentations/fy21_investor_pres_final.pdf; AGL, 2021 Full Year Results Briefing, p, 4, August 2021, https://www.agl.com.au/about-agl/investors/webcasts-presentations.

[59] We first used our Section 37 powers under the ESC Act to formally request cost data from retailers in September 2019. We consider the data collected via this process is fit for the purpose of determining an appropriate range for efficient costs. The most recent cost data available to us is for financial year 2019-20. We are currently in the process of verifying this data which will have been completed and analysed by the time we make our final decision and determination on 1 January 2022 VDO prices.

[60] We note that statements and estimates published by retailers are based on independently audited information and are subject to obligations under the Corporations Act 2001 to be reasonable and supportable.

[61] Including the Reserve Bank of Australia's Statement of Monetary Policy (November 2020), p. 1.

- government support programs, Job Keeper and Job Seeker, and additional customer support requirements would likely soften the impact of bad debts in 2021.

We noted the temporary allowance for bad debt would be removed from the VDO cost stack in future reviews.

The newest information suggests economic conditions are improving

Our draft decision keeps the temporary allowance we made for bad debts in the 2021 VDO, pending our final decision. We will monitor market conditions and are seeking more information from stakeholders on bad debts to inform our final decision.

We consider this reasonable given the current uncertainty regarding the health and economic environment. To be clear, on the basis of the information currently available, we plan to remove the bad debt allowance in our final decision. This view is based on:

- Economic forecasts – including Australian Bureau of Statistics data on unemployment and the Reserve Bank of Australia's statements on monetary policy. [62] [63]
- Publicly available information – AGL's annual report 2021[64] and 2021 investor briefing[65], Origin Energy's annual report 2021.[66]
- Information collected from Victorian retailers on average arrears for residential and small business customers during the pandemic.[67]

We will continue to monitor the information available in the lead up to our final decision. We note the current restrictions on movement in New South Wales and Victoria due to coronavirus outbreaks. Whether or not these outbreaks are controlled, and how quickly, may affect economic conditions in 2022.

---

[62] Australian Bureau of Statistics, labour force Australia data (reference period July 2021), 19 August 2021 https://www.abs.gov.au/statistics/labour/employment-and-unemployment/labour-force-australia/latest-release#states-and-territories.

[63] RBA, Reserve Bank of Australia's Statement of Monetary Policy, August 2021, p. 1.

[64] AGL, 2021 Annual Report, August 2021, https://www.agl.com.au/about-agl/investors/annual-reports

[65] AGL, 2021 Full Year Results Briefing, August 2021, https://www.agl.com.au/about-agl/investors/webcasts-presentations

[66] Origin Energy, 2021 Full Year Report (including appendix 4E), August 2021, https://www.originenergy.com.au/content/dam/origin/about/investors-media/presentations/fy21_origin_energy_full_year_report.pdf

[67] The commission has received voluntary data from Victorian electricity and gas retailers for the purpose of monitoring the number of energy customers receiving assistance during the coronavirus pandemic – it is available on our website. To understand the relationship and possible impact on bad debts that trends in customer bill arrears we have looked at average arrears (and the monthly change) for customers receiving payment assistance, that are unable to pay on-going usage.

We welcome additional information from stakeholders, including electricity retailers, to inform our final decision. We are particularly interested in forecasts of retailers' bad debts for 2022, and evidence supporting those forecasts.

Forecast economic conditions

In making our 2021 determination we considered subdued economic forecasts for 2021 suggested the level of average arrears and the level of bad debts in the retail electricity sector would increase. At the time, the Reserve Bank of Australia expected employment would return to pre-pandemic levels in late 2022.[68]

As mentioned above, the extent of ongoing economic impacts from the coronavirus pandemic are still uncertain. Despite this uncertainty, the most recent statistics and forecasts available show economic indicators returning to pre-pandemic levels much faster than anticipated. Labour force data recently published by the Australian Bureau of Statistics shows the unemployment rate in Victoria has fallen to 4.6 per cent in June 2021 – the lowest rate since December 2018. This improvement in economic conditions is also supported by the participation rate and employed persons figures.[69]

The Reserve Bank of Australia's economic outlook supports this trend, noting the rapid recovery in the labour market has resulted in solid growth in labour income. While the recent lockdowns are anticipated to affect consumption it is expected to rebound once restrictions ease. Noting economic growth is forecast to be a little over four per cent under the Reserve Bank's baseline scenario.[70] This suggests removing the temporary bad debt allowance may be appropriate.

Retailers' reporting on bad debts

Retailers' annual reports show an improvement in the level of bad debts for 2022. While Origin Energy and AGL are only two of many retailers that serve Victorian customers, they account for roughly 40 per cent of all customers. Given this large share of customers, their public results on bad debts may provide insight into the broader trend for the industry.

Origin Energy's 2021 annual report showed a reduction in bad debts from 2020 to 2021.[71] Bad and doubtful debts reduced from $113 million to $83 million. We note that in 2019 Origin Energy

---

[68] RBA, Statement of Monetary Policy November 2020, p. 1.

[69] Australian Bureau of Statistics, labour force Australia data (reference period July 2021), 19 August 2021 https://www.abs.gov.au/statistics/labour/employment-and-unemployment/labour-force-australia/latest-release#states-and-territories. The unemployment rate in Victoria reached a 10 year high of 7.7 per cent in November 2020. The participation rate which measures the labour force as a percentage of the working-age population is 66.0 per cent after reaching an historic high of 66.84 per cent in March 2021 (for the observed period 1978 to 2021).

[70] Reserve Bank of Australia, Statement on Monetary Policy –August 2021, pp. 1-5. Economic Outlook, https://www.rba.gov.au/publications/smp/2021/aug/pdf/statement-on-monetary-policy-2021-08.pdf

[71] Origin Energy, 2021 Full Year Report, August 2021, p. 24.

reported $80 million in bad and doubtful debts.[72] Origin Energy also reported 4.2 million customers in 2019 and 4.3 million in 2021.[73] [74] Given that customer numbers and total bad debt expense is similar for both 2019 and 2021 this suggests that bad debt levels may be returning to pre-pandemic levels.

AGL reports a total coronavirus related net bad debt expense of $29 million, which is $11 million less than AGL anticipated at the beginning of the year.[75] AGL forecasts some coronavirus related bad debt costs for 2022. It is not clear from AGL's results what the expected level will be, but it states that bad debts are expected to be lower in 2022 than in 2021.[76] We also note that the total bad debt reported by AGL in 2021 was $127 million.[77] This is similar to the $120 million reported for 2019.[78] We also note that given customer numbers increased from 3.7 million to 4.2 million between 2019 and 2021 we would expect the total bad debt expenses to also increase.[79] [80]

Our analysis of retailers' financial reports indicate that the temporary bad debt allowance is unlikely to be required in 2022. Retailers reported actual bad debt expenses are lower than forecast at the beginning of the year. We also note that, once changes in customer numbers are accounted for, the current level of reported bad debt expenses is similar to that for 2019, before the pandemic began. Both Origin Energy and AGL also reported that underlying bad debt expenses had reduced.[81] [82]

Arrears data

Throughout 2020 and 2021 electricity retailers have given the commission ongoing updates on the number of Victorian customers receiving payment assistance during the coronavirus pandemic. We have considered the level of average arrears for both residential and small business customers receiving payment assistance, who cannot pay for on-going usage. This may provide an indication of the trend in the level of bad or doubtful debts retailers may incur.

---

[72] Origin Energy, 2020 Full Year Report, August 2020, p. 31.

[73] Origin Energy, 2019 Full Year Report, August 2019, p. 4.

[74] Origin Energy, 2021 Full Year Report, August 2021, p. 2.

[75] AGL, 2021 Annual Results presentation, August 2021, p. 23.

[76] AGL, 2021 Annual Results presentation, August 2021, p. 21.

[77] AGL, 2021 Annual Report, August 2021, p. 37.

[78] AGL, 2020 Annual Report, August 2020, p. 108.

[79] AGL, 2021 Annual Report, August 2021, p. 10.

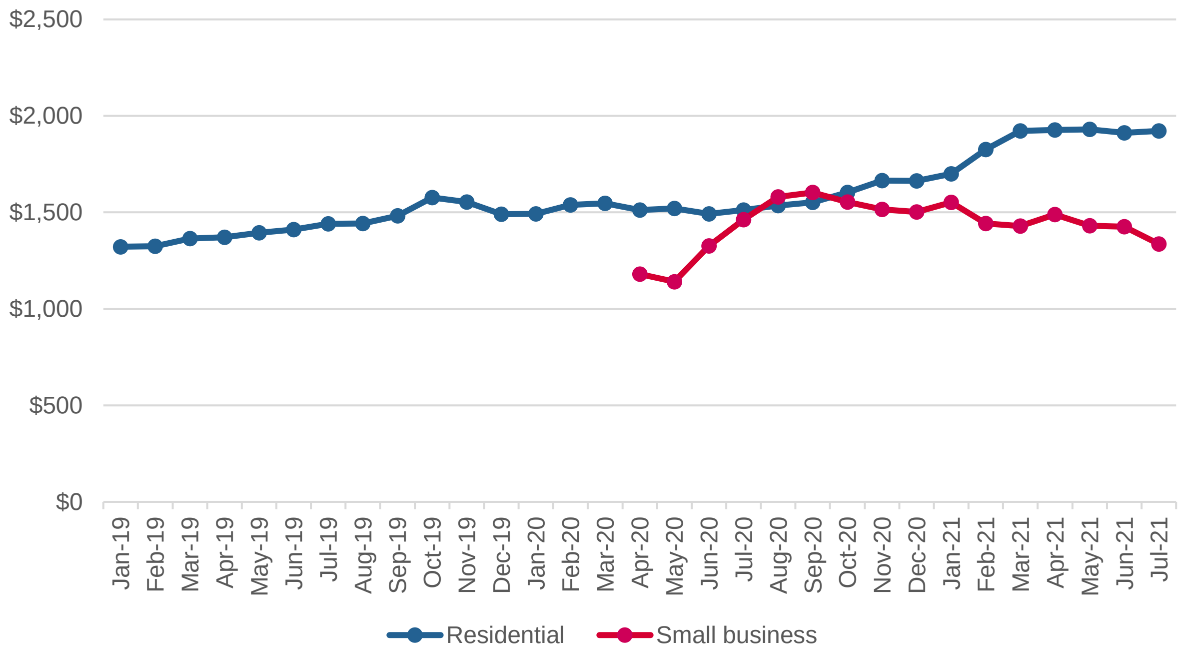
[80] AGL, 2019 Annual Report, August 2019, p. 12.

[81] AGL, 2021 Annual Report, August 2021, p. 37.

[82] Origin Energy, 2021 Full Year Report, August 2021, p. 26.

In reaching our draft decision, we observed the trend in arrears between 2021 and 2019.[83] For customers that are on payment plans that cannot pay ongoing usage, the average amount owed increased during the coronavirus pandemic. Residential customers' arrears increased mostly in February and March 2021 and have remained stable since (Figure 5 below shows this). Small business customers' arrears peaked in September 2020 but have been falling since then. As the level of bad debts for customers on payment plans appears to be stable or decreasing, rather than increasing further, it suggests that the bad debt adjustment can be removed in 2022. The increase in the average level of arrears in 2021 has already been accounted for in the temporary adjustment we made to the 2021 VDO. We will, however, continue to monitor the data we collect on average arrears.

Figure 5: Average monthly arrears for customers receiving payment assistance and cannot pay on-going usage, 2019 to 2021



Source: Energy Retailers

Notes: We began collecting data on small business customers from April 2020.[84]

[83] We have not included data prior to 2019. The way we have collected data on customer arrears changed with the introduction of the new payment difficulty framework.

[84] At the start of the coronavirus pandemic in Victoria, we sent voluntary data requests to retailers to monitor the number of energy customers (including small business customers) on payment plans and number of customers enquiring about assistance. The data has not been audited by the commission.

Stakeholder feedback on the bad debt allowance

Our consultation paper noted our intent to revisit the temporary bad debt allowance during the 1 January 2022 VDO review. The information we had at that time suggested it may be appropriate to remove the adjustment.

Several stakeholders commented on the adjustment for bad debts, with a number of retailers supporting the continuation of the allowance. Momentum Energy and Powershop MEA Group suggested the end of the JobKeeper subsidy, and the reduction to JobSeeker will have long term consumer income effects which are currently unknown.[85]

While the full economic effect of the pandemic is still unknown, as noted above, the economic outlook for 2022 is considerably better than expected in 2020. In addition to this, arrears have stabilised since JobKeeper and JobSeeker were removed.

The Australian Energy Council, Momentum Energy, Powershop MEA Group, Red and Lumo Energy, and Tango Energy described the commission's temporary regulatory controls, designed to support energy customers through the pandemic, as having hindered debt recovery practice – increasing the debt carried by retailers and delaying debt recovery (or write off).[86]

While it is possible these controls, which are no longer in place, may have contributed to the current level of average arrears in 2021 (as discussed above), the temporary bad debt allowance compensated retailers for costs incurred in 2021. As noted, we continue to monitor market developments and will consider them in our final decision.

Some stakeholders sought the removal of the temporary bad debt allowance in 2022. Both the Consumer Action Law Centre and Victorian Council of Social Service suggested providing a bad debt allowance may reduce the incentive for retailers to manage their operations in a prudent

---

[85] Momentum Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2. Powershop MEA Group, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1.

[86] AEC, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2. Momentum Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2. Powershop MEA group, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2. Red and Lumo Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1. Tango Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3.

way.[87] The Consumer Action Law Centre noted retail customers should not bear market risk, such as those associated with a pandemic, through higher retail prices.

The Consumer Action Law Centre also suggested we should consider reviewing the allowance provided for bad debt in 2021, by cross checking retail estimates (made in 2020) against actual cost data submitted by retailers as well as publicly available information, refunding customers if necessary.

We acknowledge some retailers will have per customer bad debt costs lower than the temporary allowance provided for in the 2021 VDO. Forecast of costs are estimates based on the information we have available at that time. These estimates may be above or below actual costs. In general we do not review these estimates except for some charges that are set by government bodies.

Five-minute settlement

From 1 October 2021, the settlement period for the electricity spot price will change from 30 minutes to five minutes. Five-minute settlement is designed to provide better price signals for investment in fast response technologies (batteries, new generation gas peaking power plants and demand response).

In 2021 we included a small increase to retail operating costs of $0.84 per customer per year. This was for changes to the ongoing operating expenditure associated with this new national regulatory obligation, including billing, metering and pricing functions.

Our draft decision on five-minute settlement

Our draft decision continues to provide an allowance for the ongoing operating costs associated with the introduction of five-minute settlement. While the change will commence from 1 October 2021, there are ongoing costs incurred by retailers due to the reform. We also note that consumers should benefit from this reform through lower wholesale prices. The costs due to five-minute settlements include things such as upgrades to billing and metering capabilities and improvements to pricing functionality.

While the treatment and allocation of these costs will differ between retailers, in time the effective life of any billing or metering software will require retailers to replace their systems. Accordingly, we propose to remove this cost in time, in-line with principles for depreciating software – that is often within five years of its purchase. We may also review the retail operating cost benchmark prior to this time, in which case an adjustment for five-minute settlement would not be necessary.

---

[87] CALC, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3. VCOSS, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2.

Retailers supported five-minute settlement costs but consumers did not

Our consultation paper sought views on the issue, suggesting the current allowance adequately covers retailers for ongoing changes in cost to serve for five-minute settlement. In response, Momentum Energy and Origin Energy suggested we should maintain the current allowance as it may be too early to fully understand any adverse operational costs due to five-minute settlement.[88]

The Consumer Action Law Centre suggested the allowance should be discontinued on the basis that costs associated with updating information systems should not be reflected in the VDO.[89] We have investigated retailers' estimated costs and have based the allowance on the ongoing operating costs associated with the regulatory reform. In setting an efficient estimate, we consider the cost to comply with five-minute settlement should be included in the VDO. As noted, we intend to remove this allowance over time as retailers replace their software systems in the usual course of their business.

Consumer data right

In its submission, Momentum Energy mentioned the cost impact of consumer data right reforms.[90] Momentum Energy asked us to consider adjusting the retail operating margin to account for the costs associated with the reform.

At this stage the cost impact of the consumer data right is unclear. If there is an increase in costs to serve due to the consumer data right, this should be accounted for in retail operating costs rather than in the retail operating margin. Further, we understand the consumer data right is still being developed, and it is currently planned to come into effect for the three biggest retailers from October 2022. As a result no adjustment is required at this stage.

Customer acquisition and retention costs

- Our draft decision is to keep our approach to estimating customer acquisition and retention costs (acquisition costs)
- Acquisition costs represent about three per cent of costs for the average residential bill (averaged across the five distribution zones).

---

[88] Momentum Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2. Origin Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2.

[89] CALC, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 6.

[90] Momentum Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2

- Our decision means customer acquisition and retention costs (acquisition costs) in the cost stack would slightly increase due to inflation

The pricing order requires us to include a modest allowance for acquisition costs in making our VDO price determination.[91] Our allowance reflects the costs of competing for customers in a contestable retail market. These costs include the cost of acquisition channels (such as third-party comparison websites and service providers or telemarketing sales), the cost of retention teams, and marketing costs targeted at driving customer acquisition or retention.

We propose to keep our approach to acquisition costs

We will keep our benchmarking approach to set a modest allowance for acquisition costs. The benchmark is based on cost levels from the Australian Competition and Consumer Commission's retail and electricity pricing inquiry final report.[92] We will update the benchmark for inflation.

Data suggests that the expenditure for retailers in Victoria on acquisition costs continues to grow. This spending may benefit retailers that are able to grab larger market shares, but it is still not clear how spending, above the level of our benchmark, benefits consumers as a group. As a result we propose to keep our current benchmark to limit the impact of the acquisition cost 'arms race' observed in recent years.

We have considered stakeholders' submissions on acquisition costs

Momentum Energy said that new regulatory reforms will likely increase acquisition and retention costs for retailers.[93]

The new reforms will stop door-to-door sales, cold-calling and win-back and save activities. It is not clear that these reforms will increase retailers' costs. While some retailers' acquisition costs may increase, as they switch from cold calling or door-to-door sales to other acquisition methods, the ban on win-back and save offers may lower costs.

In the short term, the ban of door-to-door sales or cold-calling may reduce acquisition costs for retailers that use those activities. In the medium to long term the ban may increase those retailers' costs if they move to other higher cost customer acquisition activities.

On the other hand, the ban on win-back and save offers will lower costs. Win-back and save offers lead to higher overall acquisition costs.[94] Acquisition costs are duplicated as both the retailer who

---

[91] Clauses 12(3) and 12(4) of the order.

[92] Australian Competition and Consumer Commission, Retail Electricity Pricing Inquiry – Final Report, July 2018.

[93] Momentum Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2.

[94] Australian Competition and Consumer Commission, Retail Electricity Pricing Inquiry – Final Report, July 2018, p.232.

has temporarily 'won' a customer and the retailer who has saved or won back the customer will have incurred costs in this activity. Stopping these activities will mean that newly acquired customers are less likely to be lost and there will be less waste spent on duplicated acquisition costs.

Retailers' actual acquisition costs have increased significantly since financial year 2014,[95] but it is not clear that retailers' current level of acquisition costs is efficient. In competitive markets, the cost of increasing market share is often funded in the short term from equity or foregone profits, not through higher prices. Also, there is evidence to suggest that acquisition expenditure is subject to an 'arms race' in which retailers spend increasing amounts in pursuit of market share, but which provides no benefit to consumers.[96] Given this, for the purpose of setting a modest allowance for acquisition costs, it is not appropriate to increase our benchmark.

Other costs

- Our draft decision is to make an allowance for other regulatory costs that are based on the latest available market information.
- Other costs make up less than one per cent of total costs for a representative customer (averaged across the five distribution zones).
- Our draft decision would marginally increase the allowance for these costs compared with the current VDO.

Other regulatory costs include a range of discrete and specific costs that retailers incur outside of costs to serve. They are generally minor relative to the total cost stack (less than one per cent) but are a relevant factor in our estimation of the efficient costs for the sale of electricity by a retailer.[97]

Australian Energy Market Operator fees

These fees are charged to recover the costs of market operation and full retail contestability functions. It also includes costs recovered for Energy Consumers Australia.

The Australian Energy Market Operator's (market operator) energy market budget and fees report contains budgeted fees and charges for 2021–22 but does not include forecast estimates for 2022–23. We plan to apply the budgeted fees for all of 2022 and monitor any changes to fees

[95] Australian Competition and Consumer Commission, Inquiry into the National Electricity Market, November 2019 Report, November 2019, p. 74.

[96] Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, 3 May, pp. 75 – 76.

[97] Clause 12(4)(f) of the order.

introduced from 1 July 2022. We note that we have only included the portion of market operator fees that are levied on retailers. This excludes the portion charged to generators.

Ancillary fees

Ancillary services are used by the market operator to manage the power system safely, securely and reliably, for frequency, voltage and system restart processes. Unlike other charges, the market operator operates separate markets for various ancillary services.

The relevant charges are dependent on the amount of service required at any particular time, which means the costs will vary from period to period. We have completed analysis of market operator data to estimate Victorian ancillary charges in the regulatory period beginning 1 January 2022. We intend to use an average of the past 52 weeks (ending 1 August 2021) of ancillary service payments in Victoria. This results in an average ancillary service payment of $0.30/MWh.

We will update this with the most recent data when we make our final decision.

Reliability and Emergency Reserve Trader costs

The Reliability and Emergency Reserve Trader is a function conferred on the market operator to maintain system reliability and system security using reserve contracts. The Australian Energy Market Operator Reliability and Emergency Reserve Trader End of Financial Year Report 2020–21 contains details of activations. As there were no activations of this function in Victoria, our draft decision makes an allowance of $0.00 per customer.[98]

Essential Services Commission licence fees

Electricity retailers are charged an annual licence fee to sell electricity to Victorian consumers. Licence fees are based on the costs we incur in performing our regulatory functions. The specific fee for each retailer is contingent on the number of customers served by that retailer.

We propose to use a market wide total of all retailer licence fees divided by the total number of customers in estimating the cost of a licence fee per customer for the VDO. The latest available data on licence fees is from 2019–20 (updated for inflation), which results in an allowance of $1.73 per customer. If the latest data on the licence fees becomes available, we will include it in our final decision.

[98] Australian Energy Market Operator, RERT End of Financial Year 2020-21 Report, August 2021.

Retail operating margin

- Our draft decision is to continue to use the benchmarking approach to the retail operating margin we used in our last VDO decision.
- Retail operating margin represents 5.7 per cent of costs for the representative user.
- Our draft decision would mean that the dollar value of the retail operating margin in the cost stack will slightly decrease.

The pricing order requires us to have regard to retail operating margin when making a VDO price determination.[99] We considered how the pandemic will affect retailers' margins and whether or not the level or methodology of the retail operating margin in the VDO should change to reflect this. Our draft decision is to maintain the approach we used to setting the retail operating margin in our last review.

Retail operating margin provides retailers incentives to invest

Retail operating margin represents the operating profit margin required to compensate investors for the capital provided to operate a retail service. It includes the cost of capital, and the systematic (non-diversifiable) risk associated with investment.[100] The retail operating margin is expressed as a percentage of the cost stack.[101] The pricing order notes that risks accounted for in other components of the cost stack (such as wholesale electricity market risk) must not be included in the retail operating margin[102], and that we are not required to base retail operating margins on actual retailer operating margins.[103]

We have kept the retail operating margin at 5.7 per cent

In our last review, we kept the regulatory benchmarking approach used in our previous decisions. This approach uses recent regulatory decisions by Australian regulators to set a benchmark for a retail operating margin.

[99] Clause 12(4)(e) of the order.

[100] Non-diversifiable risks are considered to be unavoidable and are typically attributable to market factors that affect all firms.

[101] The retail margin represents the return that an electricity retailer requires, over and above its costs, in order to attract the capital needed to provide a retailing service. The term margin is used as an estimate of profit (EBITDA) divided by sales. Holding the percentage EBITDA margin constant means that if energy, network and operating costs rise over time, the dollar margin will also rise, reflecting an increase in the required capital in dollar terms.

[102] Clause 12(7) of the order notes that in determining retail operating margin we must have regard to the principle that the margin must not compensate retailers for risks that are compensated elsewhere in the costs.

[103] Clause 12(9) of the order.

In response to stakeholder submissions from our last review, we investigated the current margins and the methodologies adopted in other jurisdictions. The range of retail margins set by Australian regulators in their latest regulatory decisions was between 5.3 to 5.7 per cent.

We also looked into the level of retail margins existing in Victoria. We analysed actual retail electricity costs from the cost data submitted by Victorian retailers. The assessment indicated that the average retail margin recovered by retailers in Victoria in the last two financial years was in line with the margin allowed in the VDO. This suggests that at a broad level there is no significant difference in the retail margins set by the commission for VDO and the existing margins in the Victorian retail electricity market.

The evidence before us does not suggest there has been a material, and ongoing, need to change the retail operating margin. As a result, we do not propose adjust the retail operating margin.

We will continue to monitor the margin and market developments and reconsider the margin if there is evidence to suggest material change in the efficient retail margin.

We also looked at international regulators that set retail electricity prices. However, due to market differences between Victoria and these international jurisdictions we did not consider these values fair comparisons.

We considered stakeholders' submissions on the retail operating margin

The majority of stakeholders generally supported basing the retail operating margin on previous regulatory decisions by Australian regulators. Some stakeholders raised concerns about increased systematic risk, compliance risk and cost risk but provided insufficient evidence to support their positions.

Simply Energy and the Consumer Action Law Centre suggested we review our current benchmarking methodology.[104] However, Simply Energy suggested the review would not need to take place until the review for the 2023–24 VDO price determination.

The impact of the pandemic

Origin Energy submitted that pandemic debt-related risks continue to persist for retailers.[105] Origin Energy recommended that we either keep the bad debt allowance and the current retail operating

---

[104] Simply Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2; Consumer Action Law Centre, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 6.

[105] Origin Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2.

margin or increase the retail operating margin if the allowance is taken out of the VDO to ensure retailers are appropriately compensated for carrying the cash flow risk of the supply chain.

The retail operating margin covers retailers' cost of capital, which includes remuneration for systematic risk through the market risk premium. The retail operating margin is set on the assumption that economic downturns, such as those caused by the pandemic, will occur. Increasing the retail operating margin to account for bad debts could double count the premium for systematic risk already included in the retail operating margin.

The impact of new regulatory and jurisdiction changes

Some retailers suggested the retail operating margin should increase due to risks associated with new regulations being implemented in Victoria.

Momentum Energy recommended that the retail operating margin should increase as new regulations often require retailers to incur significant costs to fund new regulatory market changes.[106] It identified changes including new switching rules, the new Energy Fairness legislation and the new Customer Data Right obligation that is under development.

Red and Lumo Energy also submitted that there is increased risk in retail operations due to jurisdiction and timing risks that need to be accounted for.[107] It noted increased regulatory risks due to new switching rules, new penalties for non-compliance and new risks to a retailer's cost recovery (for things such as network charges) due to the shift in timing of the VDO and restrictions to customer price increases once per year. It also mentioned the risk of under recovery as renewable energy target scheme costs are defined in April and are difficult to estimate. It called for the commission to account for these risks in our decision.

The VDO already reflects changes in network charges as they are a direct pass through. For government environmental scheme costs, to the extent that targets are different, they have been accounted for using a true-up process.

Retailers are expected to comply with new jurisdiction requirements. Based on the current VDO methodology, if there were increased costs due to new regulatory changes, then that would be reflected in retail operating costs instead of the retail operating margin. The retail operating margin should not cover firm specific risk.[108] It should only cover systematic risk. Factors that affect systematic risk include changes in external conditions that impact economic variables such as

---

[106] Momentum Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 2-3.

[107] Red and Lumo Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 2-3.

[108] Australian Energy Market Commission, Advice on best practice retail price methodology, September 2013, pp. 64-65.

interest rates or exchanges rates. We account for additional regulatory requirements in Victoria through an additional $10 on top of our retail operating cost benchmark.

Undertaking detailed review of the margin

The Consumer Action Law Centre recommended that we should conduct independent modelling to set an appropriate benchmark for an efficient retail operating margin.[109] It also submitted that there is scope to reduce the margin and to set the retail operating margin at the lowest point of the range.

As discussed above, we undertook a review of our current methodology of the retail operating margin. We looked at other approaches used by regulators and found that there is no single approach preferred by retailers in setting the retail operating margin. Even if we considered a certain approach to be more robust than others, there is no guarantee that the margin we would determine would be significantly different to the current one. Our current retail operating margin is similar to the range and level of other regulators.

Our analysis of the cost data by Victorian retailers also suggests that our retail operating margin is within the range of margins in the Victorian retail electricity market. There is little evidence to suggest that there has been a material change to the efficient retail operating margin that requires us to initiate further review of the margin at this stage.

Some retailers are concerned about the impact of the VDO on competition

Some retailers submitted concerns about the impact of the VDO on retail competition, with Tango Energy noting that the VDO has 'imposed an artificial price ceiling on electricity prices and distorted market price signals' and that this pricing behaviour is unsustainable.[110] Tango Energy also suggested that it will lead to a long-term reduction in competition and suggests that we consult with industry to understand the practical implications of regulated pricing. Alinta Energy noted that they believe that 'price regulation in the retail energy market is not in the long-term interest of Victorian consumers' as the setting and level of the VDO has a significant impact on competition.[111]

On these matters, we note the VDO is a policy decided on and implemented by the Victorian Government. It was introduced after an independent review into energy prices found that customers on standing offers were paying more than they should for electricity. The VDO sets a

---

[109] Consumer Action Law Centre, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 5-6.

[110] Tango Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3.

[111] Alinta Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1.

price that customers on standing offers pay for their retail electricity service and acts as a reference price that makes it easier for customers to compare market offers.

Our role is to determine prices for the VDO in accordance with the *Essential Services Commission Act 2001 (Vic.)* (ESC Act) established by government. Under the ESC Act, one of the matters we must have regard to is competition in the industry.[112] The comments from retailers above are relevant to this. We note retailers did not include analysis or data to support their claims.

In terms of the impacts of the VDO on competition we make the following observations.

In its May 2021 report, the Australian Competition and Consumer Commission said,[113]

> We reported in September 2020 that we would monitor the proportion of standing offer customers in Victoria, as we saw an increase between 2018 and 2019. We raised concerns around whether the lower-priced Victorian Default Offer may lead to reduced customer engagement. In 2020, the proportion of standing offer customers in Victoria decreased by 0.4 percentage points to 4.6%, bringing the proportion back down to 2018 levels. This indicates that customers in Victoria are generally still engaged in the market. Victoria continued to have the lowest proportion of standing offer customers out of the four regions, for both residential and small business customers.

In 2020-21, customers on market offers as a proportion of total customers was 94 per cent.[114] Although this proportion has slightly decreased in 2020-21, compared to the last year, it does not suggest that the VDO is significantly reducing the level of interest in engaging with the market.

Retailers also continue to provide market offers below the VDO. Figure 6 below compares the median residential market offer in Victoria to the average residential VDO bill. VDO prices are currently above the median market offer. A similar outcome is evident for small business offers. The data suggests customers are still engaging with the market and that customers still enjoy a range of retail electricity options. It also shows retailers offer market offers priced below the VDO suggesting the VDO continues to allow competition on price.

Further, we received14 licence applications for retail electricity in 2020–21, more than the number of licence applications in the previous four years combined.

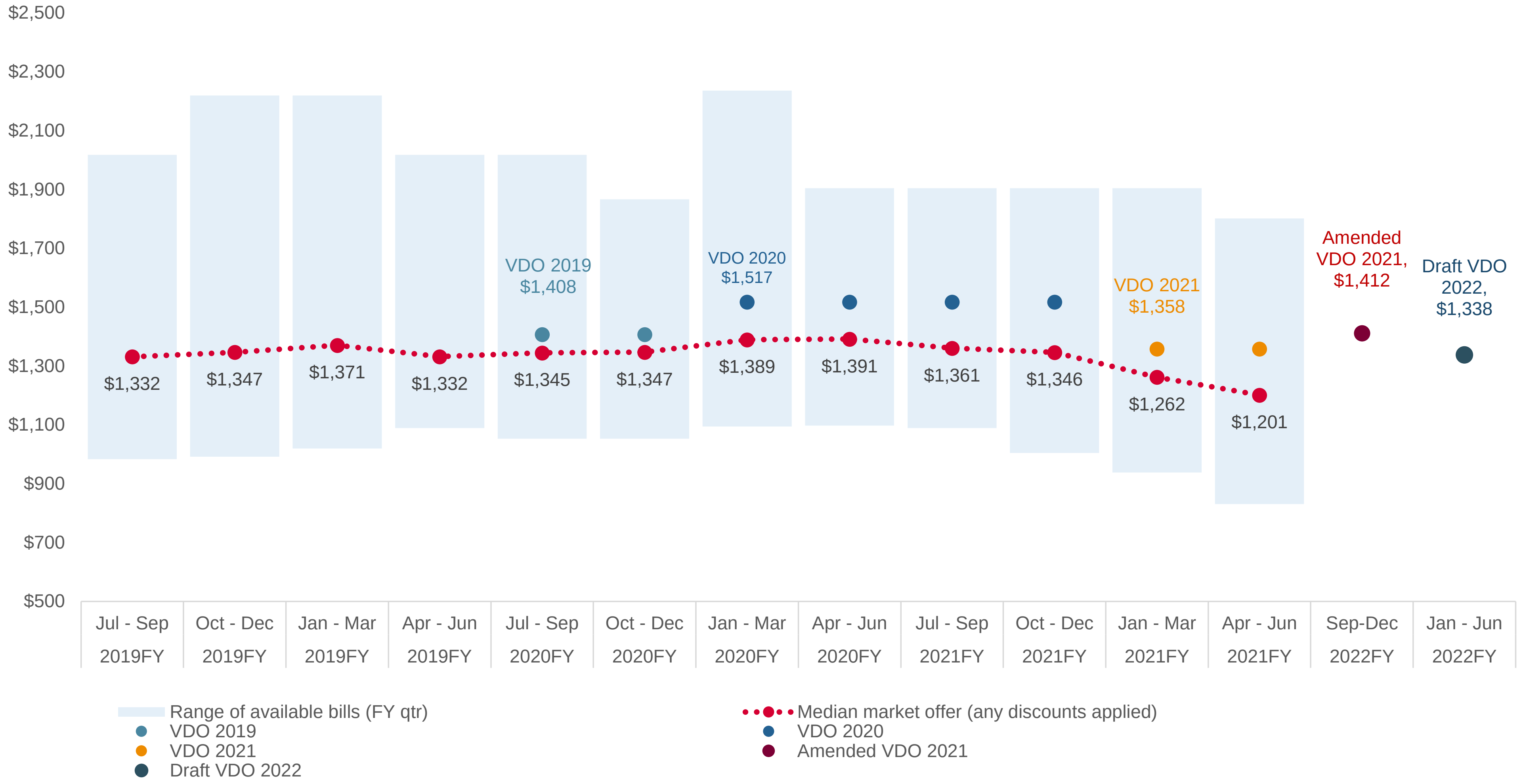
---

[112] ESC Act Section 8A(1)(c).

[113] Australian Competition and Consumer Commission, Inquiry into the National Electricity Market, May 2021, p19

[114] The customers on market offers considered were averaged across the 12 months.

Figure 6 Annual residential VDO bill compared to market offer bills (4,000 kWh/year)



Calculating VDO tariffs and maximum bills

Our draft decision is to keep the approach we used in previous VDO determinations. We will have:

- a set of VDO prices that apply to standing offers with flat tariffs
- a set of VDO prices that apply to standing offers with two-period time of use tariffs
- a compliant maximum annual bill that applies to all other standing offers.

Once we have determined the cost of providing a retail electricity service, we turn the costs into prices for the Victorian Default Offer (VDO) using three different methods:

1. **flat VDO tariffs -** for standing offers with flat tariffs
2. **two-period time of use tariffs –** for standings offer with two-period time of use tariffs
3. **the maximum bill -** for standing offers with non-flat tariffs, other than two-period time of use tariffs.

From 1 September 2021, we introduced two-period time of use VDO tariffs. The compliant maximum annual bill is based on the two-period time of use VDO tariffs rather than the flat VDO tariffs.[115]

Tariff structure

Because of underlying network charges, almost all tariffs contain a fixed, daily supply charge and a variable, per kilowatt hour charge.

The variable charge can be structured in different ways. Under a flat or anytime usage tariff, the variable charge does not change based on the time of consumption. In contrast, time of use tariffs and other non-flat tariffs have different variable charges for electricity used at different times. Under a time of use tariff structure, using energy during times of peak and shoulder demand is generally more expensive.

[115] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, p. 10.

Our draft decision on flat VDO tariffs

Our draft decision is to use the same approach to setting standing offer rates for flat tariffs as we did in our 2021 VDO determination. Under this approach, we align the VDO tariff structures with the underlying flat network tariffs in each distribution zone.

Having a flat VDO tariff provides a simple option for standing offer customers. This is consistent with the objectives of the pricing order, which states the VDO is to provide a simple, trusted and reasonably priced option for customers unable or unwilling to engage in the market. [116]

Stakeholders who made submissions on our consultation paper did not raise any substantive issues regarding our proposed approach to the flat VDO tariffs.[117]

Cost allocation

To set the rates for flat tariffs, we must identify how costs should be allocated within that structure.

Consistent with our previous VDO determination, we propose that fixed costs are included in the daily supply charge and any costs that vary with usage are included in the variable charges (per kilowatt hour charge).

VDO flat tariff cost allocation

Daily supply charge (fixed costs) =

(retail operating costs including customer acquisition and retention + fixed network costs + per customer ancillary and feed in tariff social cost of carbon) x (1 + retail operating margin)

Usage charge (variable costs) =

(wholesale electricity costs + environmental program costs + variable ancillary costs + electricity network losses + variable network costs) x (1 + retail operating margin)

[117] Essential Services Commission, Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, May 2021.

Two-period time of use tariffs VDO

Our draft decision is to use the same approach to setting standing offer rates for two-period time of use tariffs as we did in our amended 2021 VDO determination.[118] Under this approach, we align the VDO tariff structures with the underlying two-period time of use network tariffs.

In their submissions to our consultation paper, stakeholders generally supported our approach to two-period time of use VDO tariffs.[119]

Cost allocation

To set the rates for the two-period time of use tariffs, we must identify how costs should be allocated within that structure.

As with the flat tariffs we use a simple and logical method to allocate costs. Fixed costs are contained in the daily supply charge. Any costs that vary with usage go into the variable, per kilowatt hour charge component of the VDO tariffs. The variable cost components for peak and off-peak usage charges are the same except for network costs. We use the Australian Energy Regulator's approved two-period time of use network tariffs and apply them accordingly.

Cost allocation two-period time of use tariffs

Daily supply charge (fixed costs) =

(retail operating costs, including customer acquisition and retention + fixed network costs + per customer ancillary and feed in tariff social cost of carbon) x (1 + retail operating margin)

[118] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, pp. 9–14.

[119] Simply Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 24 May 2021, p. 1; AGL, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 25 May 2021, p. 1; Alinta Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 25 May 2021, p. 1; EnergyAustralia, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 25 May 2021, p. 1; Origin Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 25 May 2021, p. 1; Powershop, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 25 May 2021, p. 1; Red and Lumo Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 25 May 2021, p. 1; 1st Energy did not specifically mention its support to our proposed approach but seems to imply that it has no issues with it, except for timing and full cost recovery (1st Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 25 May 2021, p. 1); Alinta Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 16 June 2021, p. 2.

Peak usage charge (variable costs) =

(wholesale electricity costs + environmental program costs + variable ancillary costs +

electricity network losses + variable network costs for peak period) x (1 + retail operating margin)

Off peak usage charge (variable costs) =

(wholesale electricity costs + environmental program costs + variable ancillary costs +

electricity network losses + variable network costs for off-peak period) x (1 + retail operating margin)

Our draft decision is to keep our approach to the maximum customer bill

In addition to setting the flat and two-period time of use tariffs described above, our draft decision is to regulate all other standing offers (for example, non-standard time of use and demand tariffs) through a compliant maximum annual bill.

This is consistent with the approach we took to amending the 2021 VDO price determination. In our amended 2021 VDO price determination, we specified that tariffs, other than the two-period time of use and flat VDO tariffs, would be regulated through the compliant maximum annual bill. The compliant maximum annual bill amount is calculated based on the two-period time of use VDO tariffs.

Retailers offering non-flat standing offer tariffs must make sure their tariffs do not result in a bill above the compliant maximum annual bill at a specific usage amount determined by the commission. The maximum annual bill helps to ensure that all standing offer customers are covered by the VDO, without removing the option of other non-flat standing offer tariffs.

Annual reference consumption amount

The annual reference consumption amount used to determine the VDO compliant maximum annual bill amount is as follows:

- For domestic customers, there will be five maximum annual bills (one for each distribution zone), calculated for a representative customer consumption of 4,000 kWh per year.
- For small business customers, there will be five maximum annual bills (one for each distribution zone), calculated for a representative customer consumption of 20,000 kWh per year.

For the purposes of calculating the compliant annual maximum bill amount, the amount of electricity used by customers is assumed to be the same on each day of the year.

Representative usage profiles and related usage allocations

Our draft decision uses the same usage profiles for calculating the compliant maximum annual bill amounts as we used in the amendment of the 2021 VDO decision. These usage profiles are in the tables below. We used manually read interval meter data provided by the Australian Energy Market Operator to calculate these profiles.

Table 4: Domestic – usage profile for maximum bill calculation

Customer class	Peak period	Off peak
Time period window	3.00pm–9.00pm every day	All other times
Usage profile	0.33	0.67

Table 5: Small business – usage profile for maximum bill calculation

Customer class	Peak period	Off peak
Time period window	9.00am–9.00pm weekdays	All other times
Usage profile	0.49	0.51

Calculating the compliant maximum annual bill amount

The VDO compliant maximum annual bill amount for other non-flat standing offers is calculated using the relevant annual reference consumption amount and relevant usage profiles as specified above for domestic and small business customers and applying the two-period time of use tariff, as determined by the commission, for that customer in the relevant distribution zone, for an assumed supply period of 365 days.

Retailers must show they comply with maximum annual bill amount

If offering non-standard tariffs (standing offer tariffs that are not the flat VDO or two-period time of use VDO tariffs) a retailer must show those tariffs do not exceed the relevant VDO compliant maximum annual bill amount.[120]

[120] Using a representative usage profile, or relevant usage allocations, which reflect an estimate of consumption for the applicable group of customers in the 12-month period beginning 1 January 2021.

A retailer's estimated annual electricity bill for a non-standard tariff must be calculated using the relevant annual reference consumption amount determined by the commission. It must also reflect the retailer's relevant published representative usage profile.

We considered stakeholders' submissions on the maximum bill

Origin Energy's submission notes their preference for the two-period time of use VDO over the existing compliant maximum annual bill arrangements as it is simpler, consistent and more transparent. It considers that using a compliant maximum annual bill based on the two-period time of use VDO tariffs is appropriate for other non- flat tariff standing offers.[121] Similarly, the Consumer Action Law Centre comment on the difficulties of complex pricing arrangements. However, the Consumer Action Law Centre notes that a compliant maximum bill should make things simpler and comparison between offers easier.[122]

Over time, non-standard tariffs may become less common. This will make standing offer prices simpler and more transparent. However, even if this happens having a compliant maximum annual bill would still provide benefits. The compliant maximum annual bill makes sure that all standing offer customers are covered by the VDO.

[121] Origin, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3.

[122] CALC, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 7.

Length of the regulatory period

- Our draft decision is to set the 2022 Victorian Default Offer (VDO) regulatory period for the six months from 1 January 2022 to 30 June 2022.

The pricing order sets out that the regulatory period for a VDO determination is 12 months. Currently, VDO regulatory periods run for a calendar year. However, the pricing order provides for the regulatory period to be extended or reduced by six months if special circumstances exist.

Network tariffs change each financial year

In 2020, the Victorian Government passed legislation to align the regulatory periods for the Victorian network businesses with those for other jurisdictions to run on a financial year basis. However, the VDO is currently running on a calendar year cycle with the next VDO starting 1 January 2022.

For practical reasons we propose a six-month period

Network costs represent one of the largest parts of the VDO cost stack. In this draft decision they represent about 38 per cent of costs in the average residential bill. Given the large impact network tariffs have on the VDO, VDO regulatory periods should match the network periods.

To match the VDO and network regulatory periods we proposed two options on the length of the regulatory period starting 1 January 2022 in our consultation paper: the period could be six months or 18 months.

We consider a six-month regulatory period better serves the long-term interests of Victorian consumers. A six-month regulatory period will provide for quicker alignment between VDO regulatory periods and network tariff regulatory periods. A six-month period is also supported by most stakeholders. Consequently, our draft decision is to set the 1 January 2022 VDO regulatory period for the six months from 1 January 2022 to 30 June 2022.

We considered stakeholders’ feedback on our consultation paper

In our consultation paper, we sought stakeholder feedback on whether the length of the regulatory period beginning 1 January 2022 ought to be six months or 18 months.

In summary, a six-month regulatory period has the support of most stakeholders who made submissions including the Australian Energy Council and the Consumer Action Law Centre. While we acknowledge the concerns of some retailers who expressed a preference for an 18-month period, we do not consider these costs to outweigh the benefits of a six month regulatory period.[123]

We also consulted with the Minister for Energy, Environment and Climate Change on the length of the regulatory period as required under the pricing order.[124] The Minister noted broad support from stakeholders for a six month period (letter available on our website).[125]

Most stakeholders support a six month regulatory period

The vast majority of submissions expressed support for a six-month regulatory period. Simply Energy, Momentum Energy, Origin Energy, Alinta Energy, Powershop, AGL, Red and Lumo Energy, the Consumer Law Action Centre and the Australian Energy Council all expressed support for a six-month period. The main reasons were:

- there is increased risk of forecasting error over a longer regulatory period leading to a divergence between the VDO and retailers' efficient costs[126]
- a six-month regulatory period would provide more flexibility in adjusting cost stack components in response to developments with the coronavirus pandemic[127] [128]
- this will lead to quicker alignment between Victorian network businesses regulatory periods and the VDO (and expedite the benefits of synchronised regulatory periods)[129]

---

123 Shell Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1.

124 Clause 11(3) of the pricing order.

125 The Honourable Lily D'Ambrosio Minister for Energy Environment and Climate Change, Change to regulatory period for Victorian default offer to align with network tariffs, 11 August 2021.

126 Simply Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1; Alinta Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2; Meridian Energy Group (Powershop), submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2; AGL, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1-2.

127 Origin Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3.

128 Simply Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1.

129 Origin Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3; AGL, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1-2; Momentum Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 4; Red and Lumo Energy, submission to the Essential Services Commission Next

Shell Energy expressed a preference for an 18 month regulatory period.[130] It noted the regulatory burden and operational costs on retailers that more frequent bill change notices would induce. The Australian Energy Council, on the other hand, considered that an 18 month regulatory period 'would greatly increase the risks faced by retailers and consumers, for little benefit given a price change would need to occur after six months in any event'.[131]

The Victorian Council of Social Services expressed indifference on the length of regulatory period noting there were benefits and disadvantages to both approaches.[132]

There were suggestions to extend the current determination

In its submission, EnergyAustralia considered both a six month regulatory period and an 18-month regulatory period undesirable. It proposed that the commission extend the current VDO until June 2022.[133] Tango Energy's submission also suggests extending the current determination (with adjustments made for parts of the cost stack that have experienced substantial changes).[134]

An extension of the 2021 determination is inconsistent with the pricing order. Under clause 10.1 of the pricing order we must make a new price determination before the next VDO regulatory period starts: in this case 1 January 2022. However, in our determination we have included a clause that provides for the VDO to continue apply should we not make a determination. This is intended as a back-up measure if for some unforeseen reason we are not able to make a determination. This said, it is our intention, to always make a VDO determination before the start of each regulatory period: as required by the pricing order.

Retailers should only increase market offer prices once a year

EnergyAustralia requested us to allow retailers to increase their market offer tariffs after the next VDO takes effect on 1 January 2022. [135] It submitted that retailers should be allowed to link existing

---

steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 3.

[130] Shell Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1-2.

[131] Australian Energy Council, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2-3.

[132] Victorian Council of Social Service, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 2-3,

[133] EnergyAustralia, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, pp. 1-2.

[134] Tango Energy, submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, June 2021, p. 1-3.

[135] EnergyAustralia, supplementary submission to the Essential Services Commission Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, August 2021, pp. 2-4.

market offer tariffs to the VDO at each point the VDO changes. It also submitted that allowing retailers to link prices to changes in the VDO supports the effectiveness of the VDO as a benchmark of the price against which all market offers are compared.

It is not clear to us why retailers would need to change their market offer prices in response to changes in VDO prices. Retailers might change their market offer prices based on changes in their underlying costs. Changes in VDO prices do not change retailers' underlying costs. The Energy Retail Code clauses that limit market offer price increases to once a year specifically tie market price increases to network tariff changes, rather than VDO price changes, for this reason.

Our expectation is that retailers should meet the requirements of the Energy Retail Code. The objective of clause 46AA is to provide small customers on market offers with price certainty, by ensuring that retailers can only increase prices once a year (noting in any case, under our draft decision the VDO will be lower from 1 January 2022). For many customers this will occur on the date one month after network tariff prices change. For customers on fixed-price contracts, price increases can only occur on the anniversary of the fixed-price period expiring.[136]

We further note that retailers are free to lower their prices for existing customers or change prices for **new** market offers at any time.

[136] ESC, Energy Retail Code (version 21), July 2021, pp. 57-58.

Appendix A: Network tariffs reflected in the VDO

For our draft decision, to calculate network charges we will take the simplest network tariff in each distribution zone. We will also use the simplest controlled load tariff for domestic customers and the simplest advanced metering infrastructure charges for single phase meters. We have done this as they are the most commonly used charges.

Table A.1 Network tariff categories

Distribution zone	Domestic tariff	Small business tariff
AusNet Services	Small residential single rate, NEE11	Small business single rate, NEE12
CitiPower	Residential single rate, C1R	Non-residential single rate, C1G
Jemena	Single rate, A100/F100a/T100b general purpose	Small business A200/F200a/T200b
Powercor	Residential single rate, D1	Non-residential single rate, ND1
United Energy	Low voltage small 1 rate, LVS1R	Low voltage medium 1 rate, LVM1R

Table A.2 Controlled load network tariff categories

Distribution zone	Domestic controlled load or dedicated circuit tariff code
AusNet Services	NEE13
CitiPower	CDS
Jemena	A180
Powercor	DD1
United Energy	LVDed

Appendix B: Calculation of the cost stack

This appendix provides a summary of the key figures required to understand our draft decision on the cost stack we use to determine the VDO tariffs and maximum bill.

Wholesale electricity costs

We engaged Frontier Economics to estimate wholesale electricity costs for 2022 using the method described in the chapter on VDO cost components. This methodology produces an estimate based on a 12-month trade weighted average of future contract prices, assuming hedging strategies that minimise the level of risk and an allowance for volatility.

These costs vary across Victoria as a result of different customer load profiles in each distribution zone. Calendar year 2022 estimates of the wholesale electricity price and volatility allowance for each zone are displayed in the table below.

Table B1: Wholesale electricity forecasts for 2022, as of 28 July 2021 (GST exclusive)

Distribution zone	Domestic		Small business	
	Wholesale price - 12 month ($/MWh nominal)	Volatility allowance ($/MWh nominal)	Wholesale price - 12 month ($/MWh nominal)	Volatility allowance ($/MWh nominal)
AusNet Services	$70.94	$0.30	$62.64	$0.24
CitiPower	$67.24	$0.30	$63.90	$0.23
Jemena	$73.25	$0.30	$63.96	$0.23
Powercor	$69.23	$0.30	$60.92	$0.19
United Energy	$73.75	$0.33	$65.26	$0.24

Source: Frontier Economics, Wholesale electricity costs for 2022, 25 August 2021

Network losses

When transporting electricity through transmission and distribution networks, some electricity is lost in the process. The percentage lost overall is the total loss factor and represents the additional amount retailers must purchase when serving the consumption needs of their customers. These loss factors are also applied to the Large-scale Renewable Energy Target, Small-scale Renewable Energy Scheme and Victorian Energy Upgrades obligations of retailers.

We have calculated the total loss factor based on the 2021-22 distribution and marginal loss factors published by Australia Energy Market Operator.[137]

Table B2: Network losses

Distribution zone	Distribution loss factor (DLF)	Marginal loss factor (MLF)	Total loss factor
AusNet Services	1.0686	1.0017	7.04%
CitiPower	1.0525	0.9976	4.99%
Jemena	1.0430	0.9989	4.19%
Powercor	1.0806	0.9942	7.43%
United Energy	1.0525	0.9958	4.80%

Source: Australian Energy Market Operator, Distribution Loss Factors and Marginal Loss Factors 2021-22

Network costs

Electricity retailers must pay network costs including distribution, transmission and jurisdictional costs. To pay for these costs, electricity distribution businesses charge retailers by way of a network tariff, generally comprised of a fixed daily charge and a per kilowatt usage charge, and an annual per customer metering charge.

Tables B.3 and B.4 show the Australian Energy Regulator approved flat network tariffs for the period 1 July 2021 to 30 June 2022 for the purposes of our draft decision.

[137] Australian Energy Market Operator, Distribution Loss Factors for the 2021-22 Financial Year, July 2021, p. 13-16; Australian Energy Market Operator, Regional and Marginal Loss Factors: FY 2021-22, July 2021, p. 24-29.

Table B.3 Domestic electricity network charges, flat tariff, 2022 (GST exclusive)

Distribution zone	Daily charge ($ per year)	Variable charge structure	Variable charge ($ per kWh)	Controlled load ($ per kWh)
AusNet Services	$111.11	Block 1	$0.1145	$0.0426
		Block 2	$0.1284	
CitiPower	$90.01	Anytime	$0.0805	$0.0247
Jemena	$82.20	Anytime	$0.0867	$0.0360
Powercor	$139.98	Anytime	$0.0815	$0.0239
United Energy	$80.01	Anytime	$0.0799	$0.0217

Source: Victorian distribution businesses' Australian Energy Regulator approved 2021–22 pricing proposals.

Table B.4 Small business electricity network charges, flat tariff, 2022 (GST exclusive)

Distribution zone	Daily charge ($ per year)	Variable charge structure	Variable charge ($ per kWh)
AusNet Services	$111.11	Block 1	$0.1554
		Block 2	$0.1827
CitiPower	$160.02	Anytime	$0.0821
Jemena	$134.47	Anytime	$0.1097
Powercor	$179.98	Anytime	$0.0929
United Energy	$120.01	Anytime	$0.0879

Source: Victorian distribution businesses' Australian Energy Regulator approved 2021–22 pricing proposals.

Tables B.5 and B.6 show the Australian Energy Regulator approved two-period network tariffs for the period 1 July 2021 to 30 June 2022 for the purposes of our draft decision.

Table B.5 Domestic electricity network charges, two-period time of use network tariffs, 2022 (GST exclusive)

Distribution zone	Daily charge ($ per year)	Peak variable charge ($ per kWh)	Off-peak Variable charge ($ per kWh)	Controlled load ($ per kWh)
AusNet Services	$111.11	$0.2085	$0.0434	$0.0426
CitiPower	$90.01	$0.1594	$0.0398	
Jemena	$82.20	$0.1349	$0.0389	
Powercor	$139.98	$0.1587	$0.0396	
United Energy	$80.01	$0.1579	$0.0395	

Source: Victorian distribution businesses' Australian Energy Regulator approved 2021–22 pricing proposals.

Table B.6 Small business electricity network charges, two-period time of use network tariffs 2022 (GST exclusive)

Distribution zone	Daily charge ($ per year)	Peak variable charge ($ per kWh)	Off-peak variable charge ($ per kWh)
AusNet Services	$111.11	$0.1751	$0.0427
CitiPower	$160.02	$0.1302	$0.0289
Jemena	$242.12	$0.1433	$0.0305
Powercor	$179.98	$0.1475	$0.0328
United Energy	$120.01	$0.1399	$0.0311

Source: Victorian distribution businesses' Australian Energy Regulator approved 2021–22 pricing proposals.

Table B.7 shows the Australian Energy Regulator approved network metering charges from 1 July 2021 to 30 June 2022.

Table B.7 Network metering charges, 2022 (GST exclusive)

Distribution business	Annual metering charge ($ per customer)
AusNet Services	$63.70
CitiPower	$59.40
Jemena	$54.19
Powercor	$58.00
United Energy	$42.92

Source: Victorian distribution businesses' Australian Energy Regulator approved 2021–22 pricing proposals.

Under or over recovered network costs for July and August 2021

Box B.1 illustrates our approach to estimating under or over recovered network costs for the months of July and August 2021 for customers on the flat VDO tariff and two-period time of use VDO tariffs.

Table B.8 shows the usage we used for estimating under or over recovered network costs for each distribution zone and customer type.

To establish usage profiles, we used Manually Read Interval Meter (MRIM) data provided by the Australian Energy Market Operator (market operator) for the period 1 July 2020 to 30 June 2021. The data has been filtered by the market operator to only capture customers relevant to the VDO, that is, residential and small business customers using up to 40MWh per year. Noting the MRIM data aligned with AEST we included an adjustment for daylight savings in Victoria. For each distribution zone, we calculated the proportion of total volume of electricity peak and off-peak loads consumed during the specified peak and off-peak periods. To calculate Victoria wide profiles for both residential and small business customers, we used a simple average of the profiles of each of Victoria's five distribution zones.

Box B.1: Detailed methodology for network cost true up in the 1 January 2022 VDO

Detailed methodology for network cost true up in 2022 VDO				
TARIFF	**CALCULATION**		**ALLOCATION**	
Flat rate true up	**True up cost $**	(Fixed cost $ + Variable cost $) x (1+GST) x (1+ROM)	**True up tariff**	Fixed tariff $/day
	Fixed cost $	(Supply + metering charges 2021 Variation) – (Supply + metering charges 2021 VDO) **x** No. of days[1]	**Fixed tariff $/day**	True up cost / No. of days[3]
	Variable cost $	(Usage charge 2021 Variation – Usage charge 2021 VDO) **x** Actual usage[2]		
CL true up (Residential only)	**True up cost $**	Variable cost $ x (1+GST) x (1+ROM)	**True up tariff**	Variable tariff $/kWh
	Variable cost $	(Usage charge 2021 Variation – Usage charge 2021 VDO) **x** Annual usage[4]	**Variable tariff $/kWh**	True up cost / Annual usage[5]
TOU true up	**True up cost $**	(Fixed cost $ + variable cost $) + (1+GST) x (1+ROM)	**True up tariff**	Fixed tariff $/day
	Fixed cost $	(Supply + metering charges 2021 Variation) – (Supply + metering charges 2021 VDO) **x** No. of days[1]	**Fixed tariff $/day**	True up cost / No. of days[3]
	Variable cost $	(Usage Peak charge 2021 Variation **x** Actual Peak usage[6]) **+** (Usage Off-peak charge 2021 Variation **x** Actual Off-peak usage[6]) **–** (CMAB usage charge 2021 VDO **x** Actual usage[2])		

Notes

[1] Number of days from 1 July to 31 August 2021.

[2] Actual general usage per customer in July and August 2020 (to be updated for 2021 in final decision) using total usage from Australian Energy Market Operator and total Victorian customers as at 30 June 2020 (to be updated in final decision).

[3] Number of days from 1 January to 30 June 2022.

[4] Two-month proportion of annual controlled load (CL) usage assuming uniform distribution across 12 months. Australian Energy Market Operator does not report on load profiles for controlled load dedicated circuits in Victoria.

[5] Six-month proportion of annual CL usage assuming uniform distribution across 12 months.

[6] Actual general usage in July and August 2020 proportioned for peak and off-peak windows (to be updated for 2021 in final decision) using total usage from Australian Energy Market Operator and total Victorian customers as at 30 June 2020 (to be updated in final decision).

Table B.8: Domestic customers on flat tariffs: total usage in Victoria in July and August 2020, kWh

Month	Domestic usage	Small business usage
July 2020	1,384,988,558	194,313,987
August 2020	1,297,933,782	158,824,552
Total	2,682,922,340	353,138,538

Source: Australian Energy Market Operator

The market operator does not report on the actual usage data for customers with controlled load in Victoria, so we have used the annual usage profile for these controlled load customers in the VDO order of 2000 kWh, which leads to a total usage of 333 kWh for July and August 2021.

Tables B.9 and B.10 show our estimated true ups for customers on the flat VDO tariff and two-period time of use VDO tariffs.

Table B.9 Electricity true up, flat tariff, 2022 (GST inclusive)

Distribution zone	Domestic customers	Small business customers
AusNet Services	$12.38	$23.45
Citipower	$16.96	$8.14
Jemena	$14.70	$23.83
Powercor	$14.77	$10.44
United Energy	$6.51	$0.05
Victoria (average)	$13.06	$13.18

Table B.10 Electricity true up, TOU tariff, 2022 (GST inclusive)

Distribution zone	Domestic customers	Small business customers
AusNet Services	-$6.76	-$49.51
Citipower	$15.54	$3.14
Jemena	-$3.88	$11.56
Powercor	$11.78	$4.97
United Energy	$4.98	-$4.85
Victoria (average)	$4.33	-$6.94

Environmental scheme costs

Large-scale Renewable Energy Target costs

Under the Large-scale Renewable Energy Target scheme, the liability percentage is called the Renewable Power Percentage. The Clean Energy Regulator will not set the Renewable Power Percentage for 2022 until March 2022. As an alternative the Clean Energy Regulator provides an approach for calculating a default RPP. We have engaged Frontier Economics to estimate the cost of complying with the Large-scale Renewable Energy Target. This includes estimating the default Renewable Power Percentage for 2022 (18.54 per cent) and calculating the 12-month average of 2021 futures market prices for certificates (LGCs) as reported by Demand Manager.[138]

Small-scale Renewable Energy Scheme costs

The liability percentage under the Small-scale Renewable Energy scheme is called the small-scale technology percentage. The federal Clean Energy Regulator does not publish the binding small-scale technology percentage until March 2022. However, it has published the non-binding small-scale technology percentage for 2022 at 22.40 per cent.[139] The actual binding small-scale technology percentage for 2021 was set at 28.80 per cent.

Historically, spot prices for certificates under the Small-scale Renewable Energy scheme have been at or close to the clearing house price of $40. For this reason, the price per certificate is assumed to be $40.

To set an allowance for the Small-scale Renewable Energy scheme costs, we have used the mid-point of the non-binding small-scale technology percentage for 2022 and the binding small-scale technology percentage for 2021, multiplied by the clearing house price. We have also included an allowance for the level of the difference between the forecast small-scale technology percentage we used in the 2021 VDO and the actual binding small-scale technology percentage for 2021.

We note that there have historically been significant differences between the non-binding small-scale technology percentage and the binding amount. To the extent there is a difference we will account for this through a true-up mechanism.

Victorian Energy Upgrades costs

For the cost of complying with the Victorian Energy Upgrades scheme, we use the relevant greenhouse gas reduction rate for electricity for the reference price year being assessed. The

---

[138] Available at: http://demandmanager.com.au/certificate-prices. Accessed 21 July 2020.

[139] Available at http://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-small-scale-technology-percentage.

reduction rate for 2022 has not yet been set so our draft decision uses the rate for 2021 of 0.17255. We understand that the 2022 reduction rate will be set prior to our final decision. We will update our final decision accordingly.

The cost of certificates under the Victorian Energy Upgrades scheme is estimated from historic market prices. Based on currently available information, we estimate an average price of $49.64 per certificate for 2022. Again, we will update this when we make our final decision.

Our estimate of the average price per certificate is around $18 higher than the estimate used to calculate Victorian Energy Upgrades costs for the 2021 VDO. This has increased the allowance for Victorian Energy Upgrades costs in our draft decision compared to the 2021 VDO and is reflected in an increase in both the residential and small business average annual bills.

Feed-in Tariff (social cost of carbon)

The impact of the social cost of carbon on retailer costs is based on total small-scale renewable exports in 2020-21 and customer numbers in 2020-21 multiplied by the social cost of carbon (2.5 cents).

Table B.11 Cost of complying with Environmental Schemes (GST exclusive):

Environmental scheme	Certificate price, $/MWh	Scheme liability, %	Cost, $/MWh
Large-scale Renewable Energy Target	$34.01	18.54%	$6.31
Small-scale Renewable Energy Scheme	$40.00	25.60%	$10.24
Victorian Energy Upgrades	$49.64	17.26%	$8.57
Feed-in Tariff (social cost of carbon)			$13.34/customer
Small-scale Renewable Energy Scheme adjustment allowance			$3.40
Large-scale Renewable Energy Target adjustment allowance			-$0.13

Source: ESC analysis and Frontier Economics, Wholesale electricity costs for 2021: 27 August 2020, pp 50-52.

Retail operating costs

We describe our benchmarking approach to retail costs and margin in the chapter on VDO cost components. These costs are fixed and apply equally across each distribution zone.

Retail costs

Based on our updated benchmarks, we have selected an allowance of $146.77 for retail operating costs and $39.32 for customer acquisition and retention costs (see table B.12).

Retail margin

We propose to apply a retail margin of 5.7 per cent. The retail margin represents the margin in dollars as a proportion of the total revenue.

Table B.12 Retail costs and margin (GST exclusive)

Retail costs and margin	Annual allowance
Retail operating costs	$146.77
Customer acquisition and retention costs	$39.32
Retail margin	5.7%

Other costs

Retailers incur other costs through fees for market operations and ancillary services. Information about these costs has been gathered primarily from the Australian Energy Market Operator's Budget and Fees report.[140] The estimate of our licence fee is a market-wide average based on the approved fees for the year 2021-22. We have adopted a forecast of ancillary charges based on analysis of the past 12 months of ancillary service cost data.

Table B.13 Other costs (GST exclusive)

Charge	Rate
Essential Services Commission licence fee	$1.73/customer
Australian Energy Market Operator fees	

[140] Australian Energy Market Operator, 2021-22 AEMO Final Budget and Fees.

Charge	Rate
National Electricity Market fees	$0.40/MWh
Full retail contestability	$1.35/customer
National Transmission Planner	$0.00/MWh
Energy Consumers Australia	$0.62/customer
Ancillary services	$0.30/MWh
Reliability and Emergency Reserve Trader	$0.00/customer
Total per MWh: $0.70/MWh	
Total per customer: $3.70/customer	

Appendix C: Our legislative considerations

The pricing order provides the commission's power to make a VDO price determination and imposes some constraints on that power. This chapter explains at a high level the requirements for, and matters we must have regard to in, making the determination.

The commission's statutory power to determine the VDO

In making a VDO price determination we must adopt an approach and methodology that is in accordance with section 33(2) of the *Essential Services Commission Act 2001 (Vic)* (ESC Act), and the pricing order.[141] Taken together, this means we must adopt an approach and methodology that best meets the objectives specified in the ESC Act, the commission's objectives under the *Electricity Industry Act 2000 (Vic)* and the objective of the VDO.[142]

Further, the VDO price determination must be based on the efficient costs of the sale of electricity by a retailer,[143] having regard to:[144]

- wholesale electricity costs
- network costs
- environmental costs
- retail operating costs, including only modest costs of customer acquisition and retention[145]
- retail operating margin[146]
- any other costs, matters or things we consider appropriate or relevant.

The pricing order also specifies that we must not include headroom.[147]

---

[141] Clause 12(1) of the pricing order.

[142] Best meeting the objective of the VDO is a requirement of clause 12(2) of the pricing order.

[143] Clause 12(3) of the order. Further, clause 12(8) affirms that the pricing order does not require the commission to determine tariffs based on the actual costs of a retailer.

[144] Clause 12(4) of the pricing order.

[145] Clause 12(6) of the pricing order specifies that this is to be an amount determined by the commission in its discretion.

[146] Clause 12(7) of the pricing order specifies that this is to be an amount determined by the commission in its discretion, and in doing so regard must be had to (without limitation) the principle that the margin must not compensate retailers for risks that are compensated elsewhere in the costs. Clause 12(9) of the pricing order affirms that the commission is not required to determine tariffs based on the actual retail operating margin of a retailer.

[147] Clause 12(10) of the pricing order; 'headroom' being defined in clause 4(1) as 'an allowance that does not reflect an efficient cost borne by firms operating in the market.'

Our objectives in setting the VDO

As specified in the pricing order, the objective of the VDO is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.[148]

The objective of the commission under the ESC Act is to promote the long-term interests of Victorian consumers, having regard to the price, quality and reliability of essential services. As objectives of the EI Act, the commission must adopt an approach which promotes protections for customers, the development of full retail competition and a consistent regulatory approach between the electricity and gas industries (noting there is currently no framework for the regulation of prices for retail gas services).

Without derogating from these objectives and the matters to which regard must be had under section 8A of the ESC Act outlined below, the commission must also when performing its functions and exercising its powers do so in a manner that the commission considers best achieves any objectives specified in the empowering instrument, in this case the pricing order.

In making a price determination, the commission must adopt an approach and methodology which the commission considers will best meet the objectives specified in the ESC Act and any relevant legislation. Section 33(5) of the ESC Act further states that a price determination by the commission may regulate a prescribed price for prescribed goods and services in any manner the commission considers appropriate.

Other factors the commission must have regard to

Section 8A of the ESC Act provides that in seeking to achieve the commission's objective to promote the long-term interests of Victorian consumers, the commission must have regard to the following matters to the extent that they are relevant in any particular case:

- efficiency in the industry and incentives for long term investment;
- the financial viability of the industry;
- the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries;
- the relevant health, safety, environmental and social legislation applying to the industry;
- the benefits and costs of regulation (including externalities and the gains from competition and efficiency) for consumers and users of products or services (including low income and vulnerable consumers) and regulated entities;

[148] Clause 3 of the order sets out the objective of the VDO.

- consistency in regulation between States and on a national basis;
- any matters specified in the empowering instrument (i.e. the pricing order; see discussion above).

Section 33 of the ESC Act only applies to the extent it is not contrary to the pricing order.[149] Section 33(2) of the ESC Act provides that in making a price determination, the commission must adopt an approach and methodology which the commission considers will best meet the objectives specified in the ESC Act and the EI Act.[150]

Section 33(3) of the ESC Act specifies that in making a determination the commission must have regard to:

- the particular circumstances of the regulated industry (i.e. retail electricity market) and the prescribed goods and services (i.e. standing offers) for which the determination is being made;
- the efficient costs of producing or supplying regulated goods or services and of complying with relevant legislation and relevant health, safety, environmental and social legislation applying to the regulated industry;
- the return on assets in the regulated industry;
- any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries;
- any other factors that the commission considers relevant.

In addition, section 33(4)(b) of the ESC Act provides that in making a determination, the commission must ensure that the determination takes into account and clearly articulates any trade-offs between costs and service standards.[151]

[149] Clause 12(12) of the order.

[150] Section 33(2) of the ESC Act. The section refers to 'relevant legislation', which in this circumstance means the EI Act.

[151] Under clause 12(11) of the pricing order, section 33(4)(a) does not apply to a VDO determination.

Appendix D: How we have assessed the VDO

Appendix C sets out the requirements for and matters we must have regard to in making a Victorian Default Offer (VDO) price determination. This chapter summarises, how we have considered these matters.

Our approach to this review

In coming to our draft decision on the VDO, we have built on our 2021 VDO price determination, assessed developments in the retail electricity market (since we made our last determination) and analysed the costs of providing retail electricity services, among other matters. We consider this approach and methodology best meets our legislative objectives and requirements.

Our review has used largely the same methodology as we did in our 2021 VDO price determination. As part of this review, the estimates included in the VDO cost stack have been updated to reflect changes in the market and new data that is now available. Our approach helped us establish the cost estimates that best meet our legislative objectives, including our obligation that the VDO price determination be based on the efficient costs of the sale of electricity by a retailer, in light of the matters we must have regard to (see appendix C).

We analysed the efficient costs of electricity retailers

Through issuing notices under our compulsory information gathering powers, we collected cost data from electricity retailers. This information allowed us to understand the types of costs electricity retailers incur and elements of the efficient costs of supplying electricity to customers. We sought advice from independent consultants on forecasting retailers' wholesale electricity costs and of retailers' costs of complying with environmental programs for 2022.

Our approach and methodology includes the elements listed below to estimate the efficient costs of the sale of electricity by a retailer.[152] This includes:

- **wholesale electricity costs –** based on the expected future electricity costs in the market, which also includes the cost of electricity lost when it is transported
- **network costs** – which are directly taken from tariffs approved by the Australian Energy Regulator
- **environmental costs** – using available market data on the expected future costs of meeting renewable energy schemes and the Victorian Energy Upgrades program

[152] Clause 12(4) of the order.

- **retail operating costs** – based on benchmarks from previous regulatory decisions
- **other costs** – taken directly from published reports from industry bodies
- **retail operating margin** – based on a benchmark from a comparable regulatory decision.

Some elements of the cost-stack are estimated using market data such as wholesale electricity purchase costs. We intend to update estimates of these elements for our final decision and VDO price determination to account for any changes in market data. The data provided by retailers was used as a cross check of our VDO cost stack and allowed us to compare the cost stack elements across different segments of the retail market. We also used findings from other regulators (such as decisions on the retail operating margin) in assessing the cost stack.

The VDO allowance amounts may differ from the actual costs of retailers. We have sought to estimate the efficient costs of retailers, which at times and for some retailers may diverge from actual costs. In addition, as required by the pricing order, we have not included headroom in our cost stack.

We considered the impact of the coronavirus pandemic and other changes

In considering efficient costs, we may consider any other costs additional to those identified in the pricing order, or other matters or things we, in the exercise of our discretion, consider appropriate or relevant.[153]

Among other things, our review has taken into consideration the impact of the coronavirus pandemic (the pandemic) on retailers and the retail electricity market.

Through stakeholder submissions we heard many Victorian residential and small business customers are experiencing vulnerability because of the pandemic, including payment difficulties. We have considered the information available on the impact on the retail electricity market. In considering this information we have had regard to our statutory objectives, including the financial viability of the retail energy market and promoting full retail competition.

We also had regard to other changes in the regulatory environment that may affect retailers' efficient costs: for example changes due to five-minute settlement and the consumer data right.

We considered our approach to the compliant maximum annual bill

Our price determination framework also includes a VDO compliant maximum annual bill. While our first determination was required to use a maximum bill to regulate non-flat standing offer tariffs, the requirements for subsequent decisions (including this one) allow us to decide on the best approach. In proposing a compliant maximum annual bill in this draft decision, we have had regard

---

[153] Clause 12(4)(f) of the order.

to the objective of the VDO to be a simple option and sought to provide for a framework that has regard to administrative costs of retailers and ease of understanding by customers.[154] As with other elements of our methodology, we have also had regard to the approaches adopted by other regulators including the Australian Energy Regulator's Default Market Offer.[155]

Our assessment approach helps us meet our legislative requirements

Our assessment approach helps us meet our objectives

In setting the VDO our objectives are to:

- provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.[156]
- promote the long-term interests of Victorian consumers. In seeking to achieve this objective we must have regard to the price, quality and reliability of essential services. [157]

In terms of promoting the development of full retail competition, the VDO does not prevent customers from choosing their electricity retailer. As retailers will still be free to compete for customers in the market by making offers above and below the VDO, we note that our approach to the VDO is consistent with the objective in the EI Act relating to full retail competition.

Having regard to the relevant matters under the ESC Act

In making our determination, we must have regard to a number of matters to the extent that they are relevant.[158] We have had regard to all of these matters in coming to our draft decision.

Efficiency

Efficiency is an important consideration for our decision.[159] Our approach helped us establish the tariffs that reflect the efficient costs of the sale of electricity by a retailer: including an allowance for the retail operating margin.[160] Our review used largely the same approach as our 2021 VDO price determination and the amendment to that determination.

---

[154] Section 8A(1)(e) of the ESC Act and section 10(c) of the EI Act.

[155] Section 8A(1)(f) of the ESC Act.

[156] Clauses 3 and 12(2) of the pricing order. Also consistent with section 10(c), EI Act.

[157] Section 8 of the ESC Act

[158] Sections 8A and 33(3) of the ESC Act.

[159] Section 8A(1)(a) and 33(3)(b) of the ESC Act 2001.

[160] Section 33(3)(c) of the ESC Act; clause 12(4)(e) of the order.

Financial viability

A related matter is the consideration of long-term incentives for investment and financial viability.[161] As our draft decision on the VDO reflects our estimates of efficient costs we consider that it helps promote the financial viability of the industry.

Competition within the industry

In relation to the scope for competition in the market we note setting prices at efficient costs is consistent with competition and does not preclude innovation that may lead to customers accepting market contracts that offer a better deal for them than the VDO. Likewise, it does not prevent retailers, who can lower their costs, from attracting customers by making cheaper market offers available.[162]

The relevant legislation applying to the industry

We considered other legislation that affects the efficient costs of a retailer.[163] Among other things, we considered costs associated with regulatory requirements on retailers (such as the Large-scale Renewable Energy Target, Small-scale Renewable Energy Scheme and five-minute settlements). We also note that our benchmarks of retailer operating costs, CARC and retail operating margin reflect the costs and margins of Australian retailers complying with regulatory and legislative requirements.

The benefits and costs of regulation

The VDO was introduced as part of an independent review of the gas and electricity markets in Victoria. The VDO is a simple, trusted and reasonably priced electricity option that safeguards customers unable to engage in the electricity retail market.[164] In formulating the VDO we are not required to revisit the costs and benefits of implementing the VDO.[165]

We have, however, had regard to the costs and benefits of regulation in our approach to formulating the VDO.[166] The VDO reflects a price that is based on the efficient costs of providing

---

[161] Section 8A(1)(b) of the ESC Act.

[162] Section 8A(1)(c) of the ESC Act.

[163] Section 8A(1)(d) of the ESC Act.

[164] The development of the VDO stemmed from the Independent Review into the Electricity and Gas Retail Markets in Victoria. The final report from the Independent Review recommended a range of regulatory responses were required to protect the long-term interests of consumers. See Independent Review into the Electricity and Gas Retail Markets in Victoria: Final Report, August 2017, p. 52.

[165] Under clause 12(11) of the pricing order, section 33(4)(a) does not apply to a VDO determination.

[166] Section 8A(1)(e) of the ESC Act.

retail electricity services. The efficient cost and its interrelationship with the costs and benefits of regulation have been considered throughout our decision. Further, in consulting with stakeholders, we considered the information presented to us and noted we would require strong new evidence to change our approach for most cost items. In using this already established approach we sought to minimise the amount of change and regulatory burden for stakeholders.

Consistency in regulation between States and on a national basis and any relevant interstate and international benchmarks in comparable industries:

We looked at regulation of retail electricity prices on a national basis and considered relevant benchmarks from State jurisdictions. In considering benchmarks from other jurisdictions we also had regard to the different policy intent of the relevant legislation.[167]

The particular circumstances of the regulated industry

As part of this review, the estimates included in the VDO cost stack have been updated to reflect changes in the market and new data that is now available.[168] We also had regard to actual cost data from retailers. We also considered the broader economic environment including the impact of the pandemic on retailers' costs. We have also included an additional amount in our benchmarking of retail operating costs to cover differences in regulation between Victoria and other parts of Australia.

Accounting for trade-offs between costs and service standards:

We must ensure that the determination takes into account and clearly articulates any trade-offs between costs and service standards.[169] In terms of quality and reliability of services, retailers are required to offer the VDO under the regulated terms and conditions for standard retail contracts. We consider the allowance provided to retailers under the VDO will be sufficient for retailers to ensure the quality of service experienced by customers to at least continue to meet these regulated terms and conditions.

Having regard to the other relevant matters the pricing order

Clause 12 of the pricing order provides guidance on the approach and methodology for making a VDO price determination.[170] We have considered this guidance in making our decision. The relevant matters are considered in the body of our decision including the VDO cost stack chapter, chapter on flat tariffs and maximum bill, and earlier in this appendix.

---

[167] Section 8A(1)(f) and 33(3)(d) of the ESC Act.

[168] Section 8A(1)(e) of the ESC Act.

[169] Section 33(4)(b) of the ESC Act.

[170] Clause 12 of the order.

Appendix E: submissions on the consultation paper

Name of organisation	Date received
Anonymous 1	17/05/2021
Anonymous 1	18/05/2021
Simply Energy	25/05/2021
AGL	25/05/2021
Meridian Energy and Powershop	25/05/2021
1st Energy	25/05/2021
Red Energy	25/05/2021
Alinta Energy	25/05/2021
Origin Energy	25/05/2021
EnergyAustralia	25/05/2021
Consumer Action Law Centre	25/05/2021
Anonymous 1	3/06/2021
Anonymous 2	11/06/2021
Simply Energy	16/06/2021
Momentum Energy	16/06/2021
Consumer Action Law Centre	16/06/2021
EnergyAustralia	16/06/2021
AGL	16/06/2021
Shell Energy	16/06/2021
Victoria Council of Social Service	16/06/2021
Origin Energy	16/06/2021
Alinta Energy	16/06/2021
Tango Energy	16/06/2021
Powershop MEA Group	16/06/2021

Australian Energy Council	17/06/2021
Red and Lumo Energy	17/06/2021
Origin Energy	02/07/2021
Alinta Energy	02/07/2021
Australian Energy Council	02/07/2021
EnergyAustralia	17/08/2021

Appendix F: Order in council

Victorian Government Gazette

No. S 208 Thursday 30 May 2019

By Authority of Victorian Government Printer

The Lieutenant-Governor, as the Governor's deputy, with the advice of the Executive Council on the recommendation of the Minister pursuant to section 13(1B) of the **Electricity Industry Act 2000** (the Minister having first consulted with the Premier and Treasurer pursuant to section 13(1C) of that Act), acting under section 13 of the **Electricity Industry Act 2000** makes the following Order:

1. Purpose

The main purpose of this Order is to regulate the standing offer tariffs that retailers may charge prescribed customers, through the introduction of the Victorian default offer.

2. Commencement

This Order comes into operation on the date on which it is published in the Government Gazette and remains in force until it is revoked.

3. Objective of the Victorian default offer

The objective of the Victorian default offer is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.

4. Definitions

1. In this Order:

Act means the **Electricity Industry Act 2000**;

annual reference consumption has the meaning given in clause 15(5);

controlled load tariff means a tariff for the supply or sale of electricity only for use in specific appliances that are permanently wired to the relevant electricity meter;

Example: A storage water heater is such an appliance.

controlled load usage means use by a specific appliance that is permanently wired to the relevant electricity meter;

customer type means a customer who is either a domestic customer or a small business customer, as the case may be;

distribution system means a system of electric lines and associated equipment (generally at nominal voltage levels of 66 kV or below) which a distribution company is licensed to use to distribute electricity for supply under its licence;

distribution zone means the area in which a distribution company is licensed to distribute and supply electricity under the Act;

domestic customer means a customer who purchases electricity principally for personal, household or domestic use at a supply point;

Energy Retail Code means the document of that name (version 12 dated 1 January 2019) published by the Commission as amended and in force from time to time;

ESC Act means the **Essential Services Commission Act 2001**;

flat tariff means a tariff for the supply or sale of electricity where the tariff components do not vary by reference to:

(a) the time of day;

(b) the amount of electricity distributed or supplied during the day;

(c) temperature, whether actual or forecast; or

(d) other characteristics that vary during the day.

Notes:

1. A tariff with a daily supply charge as one tariff component and a usage charge calculated by $ per kWh as another tariff component, is a flat tariff;
2. Paragraph (b) does not exclude block tariffs from being flat tariffs;
3. The definition does not exclude tariffs that vary seasonally, from being flat tariffs;

flexible tariff means a tariff for the supply or sale of electricity where the tariff components vary (wholly or partly) according to the time of day when the electricity is supplied;

former franchise customer means a person described in section 37 of the Act who is either a domestic customer or a small business customer;

general usage means any electricity usage that is not controlled load usage;

headroom means an allowance that does not reflect an efficient cost borne by firms operating in the market;

Example: An allowance that is added, so that retail prices do not act as a barrier to new entrants, is headroom.

kWh means kilowatt hour;

Minister means the Minister administering the Act;

MWh means megawatt hour;

objective of the Victorian default offer means the objective specified in clause 3;

Order means this Order;

prescribed customer: see clause 5;

quarter means a period of 3 consecutive months;

regulatory period means a period over which a VDO price determination is to apply;

Note: the first regulatory period commences on 1 January 2020.

relevant customer has the same meaning as in section 39 of the Act;

small business customer means a customer who is not a domestic customer and whose aggregate consumption of electricity taken from a supply point is not, or in the case of a new supply point is not likely to be, more than 40 MWh per annum;

standing offer tariffs means the tariffs determined by a licensee under section 35(1) of the Act and published in the Government Gazette in accordance with that section, as varied from time to time by the licensee as provided for under section 35(3) of the Act;

supply charge means a fixed charge for supplying electricity to a customer (whether charged on a daily basis or over any other period);

Note: A supply charge is also sometimes called a service charge.

supply point means, in relation to a supply of electricity to a person, the point at which that supply of electricity last leaves the distribution system owned or operated by a distribution company before being supplied to the person, whether or not the electricity passes through facilities owned or operated by any other person after leaving that point before being so supplied;

tariff component, in respect of a tariff for the supply or sale of electricity, includes the supply charge, the usage charge and any other charge that is part of the tariff for the supply or sale of electricity;

usage charge means a charge for the amount of electricity supplied or sold to a customer;

Note: A usage charge is sometimes called a consumption charge.

VDO compliant maximum annual bill has the meaning given it in clause 10(2);

VDO price determination means a price determination pursuant to clause 10;

Victorian default offer or ***VDO*** means an offer a retailer must make pursuant to this Order.

2. Despite subclause (1), in:

(a) clause 6;

(b) clause 7;

(c) clause 10(2)(a)(i),

(d) schedule 1; and

(e) schedule 2,

the following definitions instead apply:

(f) ***domestic customer*** means a domestic customer within the meaning of the definition of ‘domestic or small business customer’ in the Act; and

(g) ***small business customer*** means a small business customer within the meaning of that definition.

Notes:

1. The following terms are defined in section 3 of the Act: Commission;
domestic or small business customer; distribution
company;
electricity bill;
regulated tariff standing offer; retailer;
standing offer.

2. As at the date of the commencement of this Order, the Order in Council made under section 35 of the Act and published in the Government Gazette No. S 315 on 25 November 2008 applies for the purposes of the definition of 'domestic or small business customer' in the Act.

3. 'price determination' is defined in section 13(6) of the Act.

5. Declaration of Prescribed customers

The following customers are declared, pursuant to section 13(5) of the Act, to be prescribed customers:

(a) a domestic or small business customer;

(b) a former franchise customer who is a party to a deemed contract under section 37 of the Act; and

(c) a relevant customer who is a party to a deemed contract under section 39 of the Act.

6. Victorian default offer tariffs

1. A retailer's standing offer tariffs for sale of electricity to prescribed customers must comply with this clause.

2. During the period from 1 July 2019 to 31 December 2019, the standing offer tariffs a retailer may charge to a domestic customer, in respect of the distribution zone specified in column 1 of the table in Schedule 1, are fixed at the amounts specified in columns 2, 4 and 5 of the table for the tariff components specified in those columns.

3. During the period from 1 July 2019 to 31 December 2019, the standing offer tariffs a retailer may charge to a small business customer, in respect of the distribution zone specified in column 1 of the table in Schedule 2, are fixed at the amounts specified in columns 2 and 4 of the table for the tariff components specified in those columns.

4. Subclauses (2) and (3) do not apply to standing offer tariffs other than:

(a) a flat tariff; or

(b) a flat tariff with a controlled load tariff.

5. During any regulatory period commencing on or after 1 January 2020, a retailer's standing offer tariffs for sale of electricity to prescribed customers must comply with any VDO price determination made by the Commission that is in force.

Note: The VDO price determination will be in respect of both standing offer tariffs that are flat tariffs and standing offer tariffs that are not flat tariffs. See also clause 10.

7. Retailer must make Victorian default offer

1. A retailer's regulated tariff standing offer for sale of electricity to prescribed customers must include (specified as the '*Victorian default offer in respect of flat tariffs*'):

(a) one flat tariff that is available to each domestic customer;

(b) one flat tariff with a controlled load tariff that is available to each domestic customer with a controlled load; and

(c) one flat tariff that is available to each small business customer, which tariffs

must be:

(d) for the period from 1 July 2019 to 31 December 2019, those fixed in accordance with clause 6(2) and clause 6(3);

(e) for any regulatory period commencing on or after 1 January 2020, standing offer tariffs complying with the VDO price determination in respect of that regulatory period.

2. In addition, for any regulatory period commencing on or after 1 January 2020 and in the case of standing offer tariffs that:

(a) are not flat tariffs; or

(b) are any combination of a flat tariff, and a tariff that is not a flat tariff,

a retailer's regulated tariff standing offer must include standing offer tariffs and terms and conditions (both specified as the '*Victorian default offer in respect of the VDO compliant maximum annual bill*') that ensure the retailer's compliance with the VDO price determination in respect of that regulatory period.

8. Information about the VDO on electricity bills

1. This clause applies until such time as the amendments to the Energy Retail Code required by clause 16(2)(b) come into force.

2. A retailer's electricity bill issued to a prescribed customer on or after 1 October 2019 must include information about how the customer may access the Victorian default offer from the retailer.

3. The information required by subclause (2) must be in plain and clear English and prominent on the

electricity bill.

9. Conferral of functions and powers on the Commission

1. For the purposes of Part 3 of the ESC Act and section 12(1)(b) of the Act, the supply or sale of electricity under the Act is specified as prescribed goods and services in respect of which the Commission has the power to regulate prices.
2. The Commission may not make a price determination regulating tariffs for the supply or sale of electricity under the Act except as contemplated under this Order.

Note: See section 32 in Part 3 of the ESC Act. This Order is an empowering instrument for the purposes of Part 3 of the ESC Act: see paragraph (d) of the definition of 'empowering instrument' in section 3 of the ESC Act.

10. Commission to make VDO price determination

1. At least 37 days before the commencement of a regulatory period, the Commission must make a price determination in respect of the regulatory period that determines, for each distribution zone in Victoria:
   (a) the tariffs, or the maximum tariffs, a retailer may charge prescribed customers under a standing offer during the regulatory period; or
   (b) the manner in which the tariffs, or the maximum tariffs, a retailer may charge prescribed customers under a standing offer during the regulatory period are to be determined or calculated.
2. Without limiting subclause (1), the price determination that the Commission makes in respect of the first regulatory period:
   (a) must determine:
      i. the standing offer tariffs that are to apply in respect of flat tariffs, including, in the case of domestic customers, both flat tariffs and flat tariffs with a controlled load tariff; and
      ii. in the case of a prescribed customer who is on:
         A. a tariff that is not a flat tariff; or
         B. any combination of a flat tariff, and a tariff that is not a flat tariff,

      the maximum annual electricity bill amount that the prescribed customer is to pay under a standing offer in the regulatory period (***VDO compliant maximum annual bill***); and
   (b) may provide, in the case of the customers specified in subclause (2)(a)(ii), for how any overpayment by those customers in that regulatory period, or any year (or part year) thereof, is to be dealt with; and
   (c) may also include any other decisions or determinations that are required by this Order.
3. Despite subclause (2), the Commission may after its first price determination, determine another manner pursuant to which the standing offer tariffs referred to in that subclause are to be determined or calculated.

11. Regulatory periods for VDO price determinations

1. The first regulatory period commences on 1 January 2020.
2. Subject to subclause (3), the duration of each regulatory period is 12 months.
3. Before the commencement of a regulatory period, if the Commission considers that special circumstances exist, the Commission may, after consulting the Minister:
   (a) extend the duration of the regulatory period by up to 6 months; or
   (b) reduce the duration of the regulatory period, provided the duration of the regulatory period as so reduced is not less than 6 months.

12. Approach and methodology for making a VDO price determination

1. In making a VDO price determination, the Commission must adopt an approach and methodology that is in accordance with section 33(2) of the ESC Act and this Order.

   Note: section 33(2) of the ESC Act requires the Commission to adopt an approach and methodology that best meets the objectives of the ESC Act and of the **Electricity Industry Act 2000.**
2. In addition, the Commission must adopt an approach and methodology which the Commission considers will best meet the objective of the Victorian default offer.
3. The tariffs determined by the Commission pursuant to the VDO price determination are to be based on the efficient costs of the sale of electricity by a retailer.
4. For the purposes of subclause (3), the Commission must have regard to:
   (a) wholesale electricity costs;
   (b) network costs;
   (c) environmental costs;

retail operating costs, including modest costs of customer acquisition and retention;

(d) retail operating margin; and

(e) subject to subclause (10), any other costs, matters or things the Commission, in the exercise of its discretion, considers appropriate or relevant.

Note: Section 33(3)(e) of the ESC Act similarly requires the Commission to have regard to any other factors that it considers relevant.

5. The VDO compliant maximum annual bill must be based on:

(a) the standing offer tariffs that the Commission determines are to apply in respect of flat tariffs; and

(b) the prescribed customer's electricity usage.

6. For the purposes of subclause (4)(d), the Commission must, in the exercise of its discretion, determine the amount of modest costs of customer acquisition and retention.

7. For the purposes of subclause (4)(e), the Commission must, in the exercise of its discretion, determine a maximum retail operating margin, and in doing so must have regard to (without limitation) the principle that the margin must not compensate retailers for risks that are compensated elsewhere in the costs.

8. Subclauses (3), (4), (5) and (6) do not require the Commission to determine tariffs based on the actual costs of a retailer.

9. Subclause (7) does not require the Commission to determine tariffs based on the actual retail operating margin of a retailer.

10. In making a VDO price determination the Commission must not include headroom.

11. Section 33(4)(a) of the ESC Act does not apply to the making of a VDO price determination.

12. Otherwise, section 33 of the ESC Act applies to the making of a VDO price determination only to the extent that the section is not contrary to this Order.

Notes:

1. This Order, as an 'empowering instrument' in terms of the ESC Act, can modify the application of section 33 of the ESC Act: see section 33(1) of the ESC Act.

2. Pursuant to section 33(3)(d) of the ESC Act, the Commission must have regard to relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries.

13. **Variation of VDO price determinations**

1. Before or during a regulatory period, the Commission may, on its own initiative, vary a VDO price determination in respect of the regulatory period.

2. The Commission must specify, in a VDO price determination, the circumstances under which the Commission will consider, and the basis on which the Commission will decide on, a proposed variation and (subject to subclauses (4) and (5)) the processes to be followed to enable the Commission to make such a variation.

3. Without limiting subclause (1), the Commission may vary a VDO price determination:

(a) if an event has occurred or will occur that was uncertain or unforeseen by the Commission at the time of making the VDO price determination; or

(b) to correct a clerical error, miscalculation, misdescription or other deficiency.

4. Before making a variation, the Commission must consult in accordance with clause 14.

5. Subclause (4) does not apply if:

(a) the variation is not sufficiently material to warrant consultation in accordance with clause 14; or

(a) the need for the variation is sufficiently urgent to warrant consultation in accordance with clause 14 not being undertaken.

6. If, as a result of a variation of a VDO price determination, a retailer is or will be required to vary the retailer's standing offer tariffs, the Commission must ensure the retailer is given adequate notice before the variation to the VDO price determination takes effect.

14. **Consultation**

1. The Commission may decide the nature and extent of stakeholder consultation it will undertake when making a VDO price determination or a decision to vary a VDO price determination.

2. For the purposes of subclause (1), the Commission must have regard to its Charter of Consultation and Regulatory Practice (as amended from time to time) developed and published under section 14 of the ESC Act.

15. **Victorian default offer tariffs to be the reference tariffs for discounts**

1. This clause applies until such time as the amendments to the Energy Retail Code required by clause

16(2)(a) come into force.

Provided that, if those amendments do not provide for any matter provided for in this clause, then this clause continues to apply in respect of that matter.

2. A retailer that offers a discount to a domestic customer or a small business customer must:

(a) if the discount is in respect of the period from 1 July 2019 to 31 December 2019, disclose how the discount is calculated as against the tariffs in Schedule 1 or Schedule 2 (as the case may be), and what (in percentage or dollar terms) the reduction in tariff is in terms of those tariffs; and

(b) if the discount is in respect of a regulatory period, disclose how the discount is calculated as against the flat tariffs determined by the Commission pursuant to the VDO price determination that applies in respect of that period, and what (in percentage or dollar terms) the reduction in tariffs is in terms of those tariffs.

3. For the purposes of subclause (2), the reduction in tariffs is to be expressed as the difference between the estimated annual cost of the Victorian default offer for the customer type and distribution zone, and the estimated annual cost of the offer to which the discount relates after the discount is applied, using the annual reference consumption.

4. For the purposes of subclause (3):

(a) the estimated annual cost of the Victorian default offer is:

i. during the period from 1 July 2019 to 31 December 2019, determined by applying Schedule 3;

ii. during a regulatory period, determined by applying Schedule 3 or any other approach or methodology determined by the Commission; and

(b) the retailer must determine the estimated annual cost of the retailer's offer to which the discount relates:

i. if the tariff is a flat tariff or a flexible tariff (in either case, with or without a controlled load), by applying Schedule 3;

ii. otherwise, based on a reasonable estimate having regard to any relevant information available to the retailer; and

5. The annual reference consumption is:

(a) during the period from 1 July 2019 to 31 December 2019:

i. for domestic customers without a controlled load – 4,000 kWh general usage per annum;

ii. for domestic customers with a controlled load – 4,000 kWh general usage plus 2,000 kWh controlled load usage per annum;

iii. for small business customers (with or without a controlled load) – 20,000 kWh general usage per annum.

(b) during a regulatory period:

i. the consumption amount determined by the Commission (if any); or

ii. if no amount is determined by the Commission pursuant to subclause (5)(b)(i), the amount specified in subclause (5)(a).

6. For the purposes of subclause (5), the amount of electricity consumed is assumed to be the same on each day of the year.

7. Any percentage or dollar amount disclosed pursuant to this clause must be expressed as a whole percentage or dollar, rounded to the nearest percentage or dollar.

8. Otherwise, Division 2 of Part 2A (*Customers entitled to clear advice*) of the Energy Retail Code applies to the disclosures required by this clause.

16. **Direction to the Commission pursuant to section 13(3)(b) of the Act**

1. The Commission must, as soon as practicable after the commencement of this Order, amend the Energy Retail Code and any other instrument of the Commission to give effect to the Victorian default offer and this Order.

2. Without limiting subclause (1), the Commission must amend the Energy Retail Code (and any other instrument of the Commission) so that the Code:

(a) provides for tariffs determined by the Commission pursuant to the VDO price determination being the reference tariffs for discounts and for the methodology of that comparison; and

(b) requires a retailer's electricity bill to include information about how the customer may access the Victorian default offer from the retailer.

3. For the purposes of subclause (2)(a), the Commission must have regard to the following principles:

(a) There must be a consistent methodology for comparison of tariffs that applies to:

i. all offers of discounts by retailers; and

ii. the advertising in respect of those discounts.

(b) The methodology must apply in respect of flat tariffs and tariffs that are not flat tariffs;

(c) The methodology must (without limitation) readily allow, in respect of a regulatory period, a comparison between:

i. the discounted tariffs offered by a retailer; and

ii. the tariffs determined by the Commission pursuant to the VDO price determination in respect of that period; and

4. Any actual comparison in accordance with the methodology must be readily understandable by a prescribed customer. Subclause (3) does not limit:

(a) the matters the Commission may have regard to; or

(b) the matters the Commission may provide for by way of the amendments required by subclause (2).

17. **Review of the operation of this Order**

The Minister must cause a review of the operation and effectiveness of this Order to be undertaken before the third anniversary of the Order coming into operation.

SCHEDULE 1

Victorian default offer tariffs for period from 1 July 2019 to 31 December 2019 – domestic customers

Charges are inclusive of GST.

Distribution zone	**Supply charge ($ per day)**	**Usage charge structure**	**Usage charge (not controlled load) ($ per kWh)**	**Usage charge: controlled load ($ per kWh)**
AusNet Services	$1.1368	Block 1 (up to 1020 kWh during a quarter) Block 2 (> 1020 kWh during a quarter)	$0.2763 $0.3113	$0.2024
CitiPower	$1.1055	Anytime	$0.2325	$0.1809
Jemena	$1.0037	Anytime	$0.2547	$0.1618
Powercor	$1.2333	Anytime	$0.2403	$0.1561
United Energy	$0.9115	Anytime	$0.2620	$0.1873

SCHEDULE 2

Victorian default offer tariffs for period from 1 July 2019 to 31 December 2019 – small business customers

Charges are inclusive of GST.

Distribution zone	**Supply charge ($ per day)**	**Usage charge structure**	**Usage charge ($ per kWh)**
AusNet Services	$1.1368	Block 1 (up to 1020 kWh during a quarter) Block 2 (> 1020 kWh during a quarter)	$0.3154 $0.3605
CitiPower	$1.2972	Anytime	$0.2464
Jemena	$1.1450	Anytime	$0.2682
Powercor	$1.3611	Anytime	$0.2394
United Energy	$0.9691	Anytime	$0.2717

SCHEDULE 3

1. Estimated annual cost for flat tariff offers

The estimated annual cost for an offer for the supply or sale of electricity under a flat tariff is to be calculated as follows:

$$EAC = SC \times 365 + UC \times ARC$$

where:

EAC is the estimated annual cost of the offer;

SC is the supply charge;

UC is the general usage charge; and

ARC is the annual reference consumption for general usage.

2. Estimated annual cost for flexible tariff offers

The estimated annual cost for an offer for the supply or sale of electricity under a flexible tariff is to be calculated as follows:

$$EAC = SC \times 365 + ARC \times UC_P \times UA_P + ARC \times UC_S \times UA_S + ARC \times UC_{OP} \times UA_{OP}$$

where:

EAC is the estimated annual cost of the offer;

SC is the supply charge; and

ARC is the annual reference consumption for general usage;

and where, in respect of the relevant tariff type specified in column 1 of Table 1:

UC_P is the retailer's peak usage charge;

UA_P is the peak usage allocation specified in column 2 of Table 1; UC_S is the retailer's shoulder usage charge;

UAs is the shoulder usage allocation specified in column 3 of Table 1; UC_{OP} is the retailer's off-peak usage charge; and

UA_{OP} is the off-peak usage allocation specified in column 4 of Table 1.

3. Estimated annual cost for offers that include a controlled load tariff

The estimated annual cost for an offer for the supply or sale of electricity that includes a controlled load tariff is to be calculated as follows:

$$EAC = EAC_{GU} + UC_{CL} \times ARC_{CL}$$

where:

EAC is the estimated annual cost of the offer;

EAC_{GU} is the estimated annual cost of the offer for general usage only, calculated in accordance with clause 1 or 2 of this Schedule 3 (as the case may be);

UC_{CL} is the usage charge for controlled load usage; and

ARC_{CL} is the annual reference consumption for controlled load usage.

Table 1 – Usage allocation for flexible tariffs

Tariff type	Peak	Shoulder	Off-peak
Flexible price (3 part time of use)	0.25	0.45	0.30
5-day time of use	0.52	0.00	0.48
7-day time of use (small business customers only)	0.74	0.00	0.26
5-day time of day 9 pm off peak (United Energy distribution zone only)	0.25	0.20	0.55
5-day time of day (United Energy distribution zone only)	0.32	0.20	0.48

Dated 28 May 2019 Responsible Minister

HON. LILY D'AMBROSIO MP
Minister for Energy, Environment and Climate Change

PIETA TAVROU

Clerk of the Executive Council

Electricity Industry Act 2000

MINISTERIAL ORDER UNDER SECTION 35(3B)

I, Lily D'Ambrosio, Minister for Energy, Environment and Climate Change and Minister responsible for administering the **Electricity Industry Act 2000** (the Act), specify, pursuant to sections 35(3B)(a) and 35(3B)(b) of the Act, the following periods within which a licensee may publish a notice under section 35(3) of the Act, and the following dates on which tariffs varied in accordance with section 35(3) of the Act must take effect.

1. Commencement

This Order commences on the date that it is published in the Government Gazette.

2. Periods within which a notice varying licensee standing offers must be published

If, during the period from the date of commencement of this Order until the expiry date of this Order, a licensee proposes to publish a notice under section 35(3) of the Act, varying the tariffs determined by the licensee and published in the Government Gazette under section 35(1) of the Act, the notice may be published during the following periods:

(a) the period commencing on the date this Order commences and ending on 17 June 2019; and

(b) the period commencing on 25 November 2019 and ending on 18 December 2019.

3. Dates on which a variation to a licensee standing offer under clause 2 must take effect

Pursuant to section 35(3B)(b) of the Act, any variation to licensee standing offer tariffs under clause 2 of this Order must take effect on the following dates:

(a) if the variation is under clause 2(a) – on 1 July 2019; and

(b) if the variation is under clause 2(b) – on 1 January 2020.

4. Expiry of this Order

This Order expires on 31 March 2020.

Dated 22 May 2019

HON. LILY D'AMBROSIO MP

Minister for Energy, Environment and Climate Change