



# Victorian Default Offer 2024–25: Draft Decision Paper

Draft Decision Paper

19 March 2024



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# Summary

- Our draft decision for the 2024–25 Victorian Default Offer results in lower prices than the current prices in the 2023–24 Victorian Default Offer.
- The average annual bill for domestic customers on the flat tariff Victorian Default Offer will be 6.4 per cent lower.
- The average annual bill for small business customers on the Victorian Default Offer will be 7 per cent lower.
- The drop in those annual bills is due to lower wholesale costs. The relatively large reduction in wholesale costs is partly offset by an increase in network costs.
- In making our final decision we will update the data we use to set our cost benchmarks, including our wholesale electricity cost benchmark.
- We are seeking feedback on our draft decision by 19 April 2024, to be considered for our final decision which will be made by 24 May 2024.

## The Victorian Default Offer regulates standing offer prices

The Victorian Default Offer was introduced by the Victorian Government in 2019 through an Order made under section 13 of the *Electricity Industry Act 2000* (pricing order).<sup>1</sup> The Victorian Default Offer regulates standing offer prices for electricity in Victoria sold to domestic and small business customers.<sup>2,3,4</sup> The first Victorian Default Offer was set by the Victorian Government in 2019 based on advice prepared by us. Our first determination of Victorian Default Offer prices came into effect 1 January 2020. We have been responsible for setting Victorian Default Offer prices since then.

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<sup>1</sup> The Order in Council made under section 13 of the *Electricity Industry Act 2000* was published in the Victorian Government Gazette No. S 208 on Thursday 30 May 2019. Minor amendments to this Order have subsequently been made by Orders in Council made under section 13 of the Act and respectively published in the *Victorian Government Gazette* No. S208 Thursday 30 May 2019 and the *Victorian Government Gazette* No. G50 14 December 2023. The original Order in Council as amended is referred to in this paper as the 'pricing order'.

<sup>2</sup> A standing offer is defined in section 3 of the *Electricity Industry Act 2000*.

<sup>3</sup> A 'domestic customer' for purposes of the Victorian Default Offer is a customer who purchases electricity principally for personal, household or domestic use (see clause 4 of the pricing order).

<sup>4</sup> A 'small business customer' for purposes of the Victorian Default Offer is a customer who is not a domestic customer and whose aggregate consumption of electricity is not more than 40MWh per annum (see clause 4 of the pricing order).

## The Victorian Default Offer provides a safeguard for customers

As the Victorian Default Offer is intended to be a reasonable price, it provides an important safeguard for customers who are unable or unwilling to engage in the electricity retail market.

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 new contract
- moved into a new address and uses electricity without entering into a contract
- specifically asked for a standing offer
- moved onto a standing offer after their market offer contract came to an end.

Around 13 per cent of Victorian domestic customers and 20 per cent of small businesses are currently on the Victorian Default Offer. This represents around 418,000 customers - 360,000 households and 58,000 small businesses.<sup>5</sup>

Since 1 September 2020, the Victorian Default Offer has also applied as a maximum price for most embedded network customers (covering around 176,000 customers).<sup>6 7</sup> Electricity providers in embedded networks may set prices below the Victorian Default Offer. Embedded networks supply electricity for many domestic and small business customers in apartment buildings, caravan parks or office blocks.

We consider setting the Victorian Default Offer based on an assessment of efficient costs is in the long-term interest of customers. This is consistent with the objective of the Victorian Default Offer to provide a reasonably priced electricity option. As noted below, in its role as a reference price, the Victorian Default Offer also enables customers to more easily compare market offers.

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<sup>5</sup> Data collected through voluntary reporting from retailers as of December 2023.

<sup>6</sup> On 22 July 2020, the commission made a final decision (Essential Services Commission 2020, Maximum prices for embedded networks and other exempt sellers: Final Decision, 22 July) under clause 25A of the General Exemption Order 2017 made under section 17 of the Electricity Industry Act 2000, and published in the Victorian Government Gazette No. S390 Wednesday 15 November 2017, and further amended on 30 May 2019 and 9 July 2019, in which it determined that, with effect from 1 September 2020, the maximum price that exempt persons may charge for electricity supplied to domestic and small business customers within embedded networks, will be set at the level of the Victorian Default Offer, and will automatically update to align with pricing resets for the Victorian Default Offer.

<sup>7</sup> Figure is as of January 2024.

In terms of broader safeguards for customers, in addition to the Victorian Default Offer there are a range of customer protections in place, including requirements for retailers to provide payment difficulty assistance, and notify customers about best offers (for more information visit [our website](#)).

## **The Victorian Default Offer also acts as a comparison price**

Most customers are on market offers, not standing offers. Most market offers are available at prices below the Victorian Default Offer.

The Victorian Default Offer plays a key role as a benchmark price for these market offers. Retailers must compare their market offer prices to default offer prices when advertising. This enables customers to easily compare market offer prices and choose a plan that best suits their needs.

## **We must review prices before the end of each regulatory period**

We released our previous price determination on 24 May 2023 for the Victorian Default Offer to apply from 1 July 2023 to 30 June 2024. We refer to these arrangements for standing offers as the 2023–24 Victorian Default Offer.

Under the pricing order, we must make a new determination for the Victorian Default Offer to apply from 1 July 2024 to 30 June 2025 on or before 24 May 2024.<sup>8</sup> We refer to the new pricing arrangements for standing offers to apply from 1 July 2024 as the 2024–25 Victorian Default Offer.

In making our price determinations for the Victorian Default Offer, we are guided by the requirements of the pricing order. We must adopt an approach and methodology that best meets the objective of the Victorian Default Offer as stated in the pricing order. That objective is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.<sup>9</sup>

## **Wholesale electricity costs are lowering Victorian Default Offer prices**

The electricity that we all use is sold by electricity generators and bought by retailers in the National Electricity Market. The price for this electricity in the National Electricity Market (the spot price) changes every five minutes.

Wholesale electricity costs for 2024–25 will be significantly lower than they were for 2023–24. The futures contracts that retailers use to offer customers stable prices have decreased. Figure 1 shows the wholesale electricity cost benchmark for the average domestic flat tariff Victorian Default

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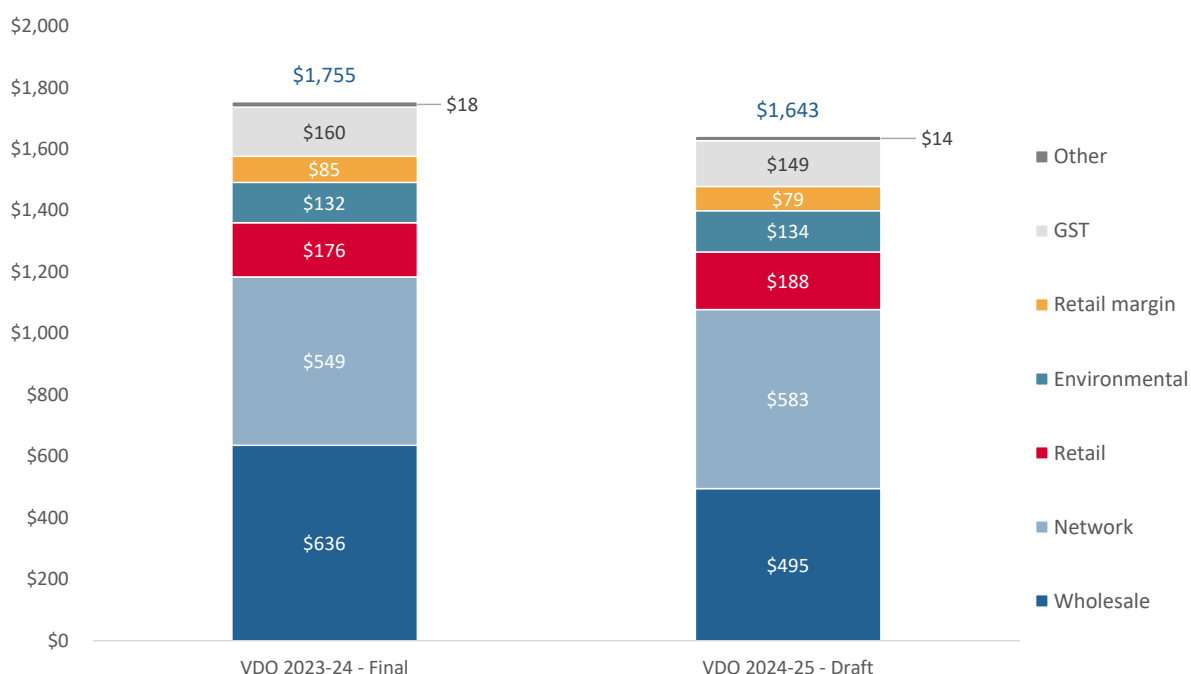
<sup>8</sup> Clause 10(1) of the pricing order.

<sup>9</sup> Clause 3 of the pricing order.

Offer customer is \$141 lower in 2024–25 than it was in 2023–24. This reduction is partly offset by an increase in network costs (\$34). This means the average domestic bill for a Victorian Default Offer customer on a flat tariff would decrease by about 6.4 per cent under our draft decision. Figures 1 and 2 show the changes in cost benchmarks between this 2024–25 Victorian Default Offer draft decision and the 2023–24 Victorian Default Offer.

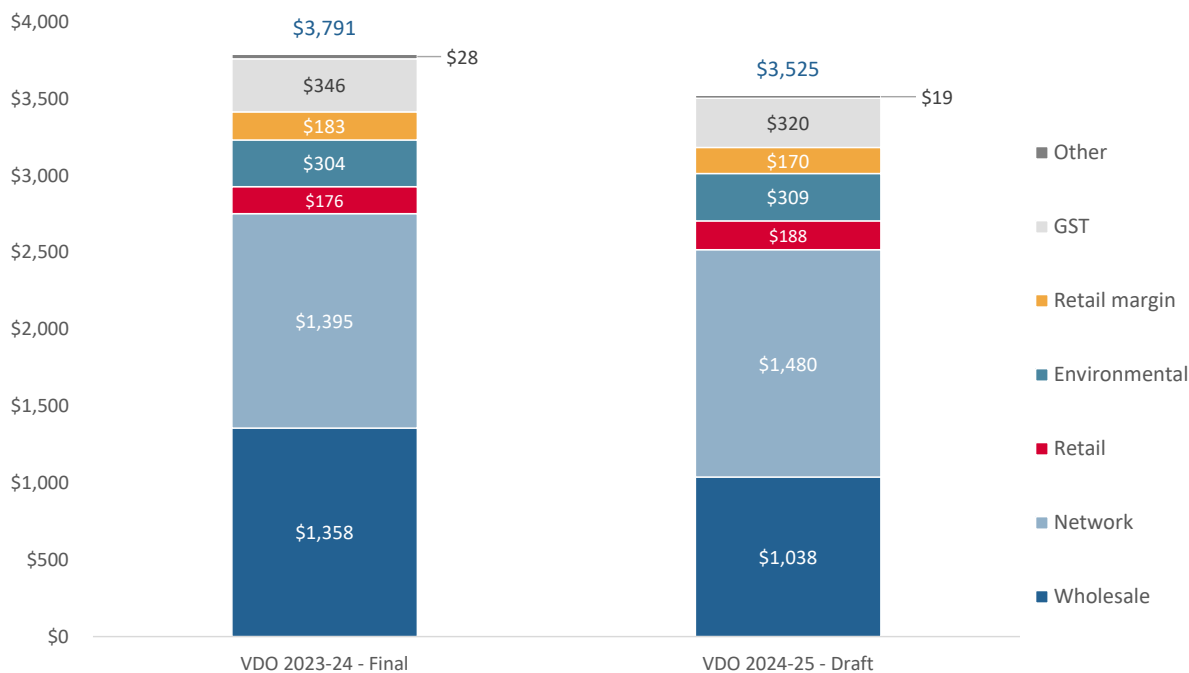
We will update our wholesale electricity forecasts for our final decision. As futures contract prices change daily, the wholesale cost benchmark adopted in our final decision is likely to be different to the one in this draft decision. For example, if generally lower contract prices for wholesale electricity continue to prevail (compared to a year ago) this would likely result in a lower wholesale cost benchmark for our final decision.

**Figure 1: Change in Victorian Default Offer annual bills for domestic customers (assuming annual usage of 4,000 kWh)**





**Figure 2: Change in Victorian Default Offer annual bills for small business customers (assuming annual usage of 10,000 kWh)<sup>10</sup>**



## We seek stakeholders’ views on the 2024–25 Victorian Default Offer

We invite stakeholders to make submissions in response to this draft decision.

For our 2024–25 draft decision we have used the same approach we used in the 2023–24 Victorian Default Offer. This approach meets the requirements of all relevant provisions, and accounts for all matters we must have regard to, under the *Essential Services Commission Act 2001*, *Electricity Industry Act 2000* and the pricing order.

In making our draft decision, we have updated our cost benchmarks to reflect changes in costs. When we make our final decision, we will update our data again, to reflect network costs approved by the Australian Energy Regulator, wholesale costs and other (smaller) parts of the cost stack dependent on market data (some environmental costs, for example).

We consider our methodology is sound. The methodology we use to calculate Victorian Default Offer prices has remained the same for a number of years (except for relatively minor changes to

<sup>10</sup> The commission has historically reported Victorian Default Offer average annual bills for small business customers assuming an average annual usage of 20,000 kWh. We have quoted the 10,000 kWh figure in the draft decision to align with how small businesses prices are reported in default market offers in other states. If assuming an average annual usage of 20,000 kWh, the draft 2024–25 Victorian Default Offer represents an annual decrease of 8 per cent (around \$569) for small business customers.

the way we estimate parts of the cost stack). Further, we consider the methodology we use has supported the achievement of Victorian Default Offer objectives over a period of fluctuating and volatile electricity market conditions. Accordingly, very strong evidence would be required for us to change our established approach to calculating prices.<sup>11</sup>

Formal submissions in response to this draft decision can be made via the [Engage Victoria website](#). We will consider these submissions before making our final decision in late May 2024. We will also hold a public forum for stakeholders to discuss the areas of our decision that we anticipate will matter most to them.

**Table 1: Timeframes for the 2024–25 Victorian Default Offer**

Key milestones	Indicative date
Draft decision released	19 March 2024
Public forum on the draft decision	28 March 2024
Submissions on the draft decision close	19 April 2024
Final decision and determination	24 May 2024

### How to provide feedback

Submissions on our draft decision should be made by 5pm 19 April 2024. We may place lower weight on, or may not be able to consider, submissions received after this date.

**Visit Engage Victoria's website to make your submission: [www.engage.vic.gov.au](http://www.engage.vic.gov.au).**

### Sensitive or confidential information

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

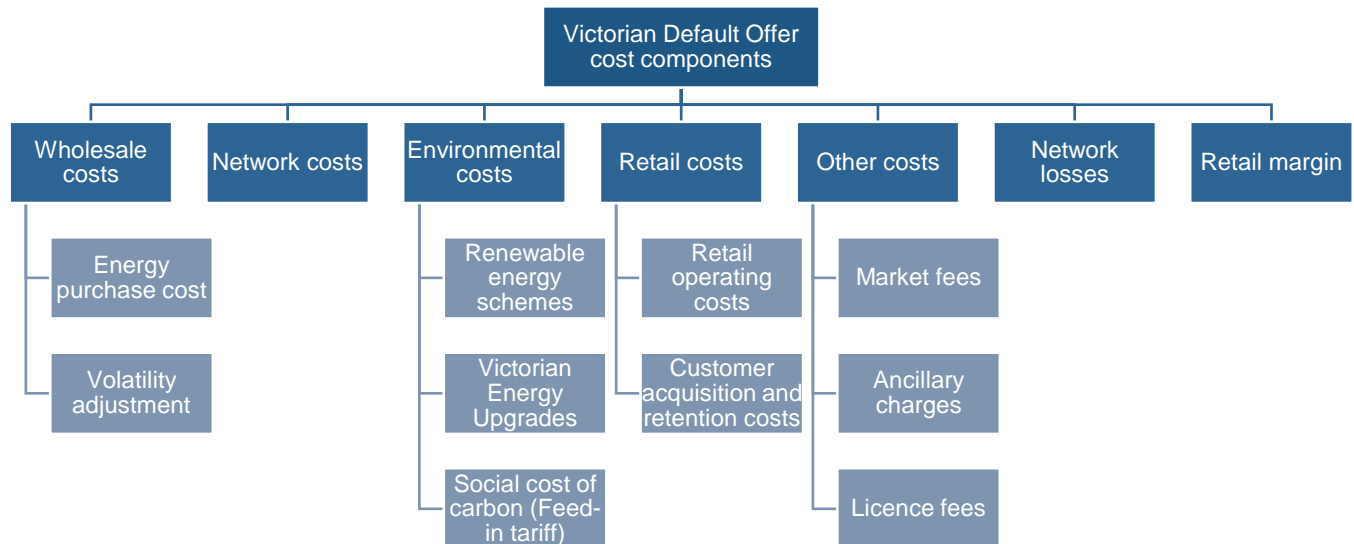
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<sup>11</sup> We note some other regulators are considering how to account for the impact of solar on the demand profiles they use for wholesale cost benchmarks. This is not an issue for the Victorian Default Offer because we use smart meter data that provides a direct picture of customers' usage across all times of the day.

# Victorian Default Offer cost components

We must base the Victorian Default Offer on the efficient costs of the sale of electricity by a retailer.<sup>12</sup> In doing this, we must have regard to specific cost components in setting tariffs.<sup>13</sup> Figure 3 shows the costs included in our Victorian Default Offer cost model.

**Figure 3: Cost items included in the Victorian Default Offer cost stack**



The cost benchmarks for the Victorian Default Offer prices are determined as follows:

- wholesale electricity costs – based on the price of electricity costs in the futures market
- network costs – taken directly from tariffs approved by the Australian Energy Regulator
- environmental costs – taken from public information on the costs of environmental initiatives
- retail costs – based on historical cost data
- other costs, including market intervention costs – taken directly from published reports from industry bodies
- network losses – taken from the Australian Energy Market Operator and electricity distributors
- retail operating margin – based on a benchmark from comparable regulatory decisions.

As part of this review, we will update the estimates included in the cost stack to reflect the most up-to-date information available for the final decision.

<sup>12</sup> Clause 12(3) of the pricing order.

<sup>13</sup> Clause 12(4) of the pricing order.

As in past years, we have collected cost data from retailers using our compulsory information gathering powers.<sup>14</sup> This year we collected information from all retailers in Victoria with more than 10,000 domestic and/or small business customers.

## Wholesale electricity costs

- Our draft decision is to use forecasts of wholesale electricity prices based on futures prices from ASX Energy. This has been our approach for all prior Victorian Default Offer price determinations.
- We reviewed the type of hedging instruments used by retailers to manage their peak wholesale price risk. We found that using a mix of ASX listed base swap and base cap contracts for our benchmark remains appropriate.
- Wholesale electricity purchase costs make up around 30 per cent of an annual domestic flat tariff bill (averaged across the five distribution zones).
- Wholesale electricity costs in our draft decision are 22 per cent lower than those in the 2023–24 Victorian Default Offer cost stack for domestic users.

Retailers face wholesale electricity costs when they purchase electricity from the wholesale market to supply their customers.

The pricing order requires us to have regard to the efficient costs of providing retail electricity services, including wholesale electricity purchase costs.<sup>15</sup> As in previous Victorian Default Offer determinations, we have used a futures market approach to set benchmark wholesale costs for 2024–25. 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.

### Retailers buy electricity in the wholesale market

Electricity generators supply wholesale electricity to the National Electricity Market which matches the supply of electricity from power stations with real time consumption by households and businesses. Electricity retailers must secure a supply of wholesale electricity. Buying electricity from the spot market exposes retailers to the risk that electricity prices may be high when they need to purchase electricity.

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<sup>14</sup> *Essential Services Commission Act 2001*, section 36

<sup>15</sup> Clauses 12(3) and 12(4) of the pricing order.

Hedging is a way of managing this risk. If a retailer hedges its wholesale electricity risk, the price it pays for electricity can be set in advance, capped, or offset. Retailers can hedge by either contracting directly with a generator, or through a financial market transaction on ASX Energy, or with another financial intermediary. While there are many different hedging products available, we use futures prices from ASX Energy. ASX Energy contracts are publicly traded so contract prices and volumes are transparent.

### **We forecast electricity prices will be lower**

Our draft decision forecast for wholesale electricity costs is 22 per cent lower than the benchmark adopted for the 2023–24 Victorian Default Offer. The driver for the change is lower wholesale electricity contract prices.

We will update our forecasts for our final decision. As futures prices change on a daily basis the wholesale cost benchmark adopted in our final decision is very likely to be different to the one in this draft decision. For example, if generally lower contract prices for wholesale electricity continue to prevail (compared to a year ago), this would likely result in a lower benchmark for our final decision.

### **Frontier Economics estimated wholesale electricity costs**

We engaged Frontier Economics to estimate wholesale electricity costs. We have considered their approach and accept that Frontier Economics' recommendations reflect an appropriate benchmark of the efficient wholesale electricity purchase costs for estimating Victorian Default Offer prices. A full description of Frontier Economics' methodology, including data sources, is included in their report.<sup>16</sup> A summary of the method is provided below.

### **Frontier uses a Monte Carlo simulation to forecast demand and spot prices**

To forecast demand and the relationship between price and demand, Frontier Economics begins by analysing historical data on load and prices. We collect half-hourly customer load data from the Australian Energy Market Operator. Frontier use this load data to undertake a Monte Carlo simulation to estimate demand. Victorian half-hourly spot prices for the same period were sourced from the market operator's publicly available data.

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<sup>16</sup> Frontier Economics, Wholesale electricity costs for 2024–25: A draft report for the Essential Services Commission, February 2024.

The Monte Carlo simulation randomly generates a year of half-hourly observations. This process is repeated 500 times to generate a range of simulated years.<sup>17</sup> Each simulated year is normalised to 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 price in each quarter is equal to the relevant quarterly ASX Energy base swap price for 2024–25, subtracting a contract premium.<sup>18</sup> These simulations give a range of possible outcomes for demand and the relationship between price and demand for 2024–25.

The Monte-Carlo simulations are based on data from the three most recent years available (financial years 2021–22 to 2023–24).

We also ask Frontier to exclude the days options contracts are exercised from the trade-weighted averages of ASX Energy prices. This is because we do not use options contracts to create a hedging position. If we were to include contracts traded on the days options are exercised this would include the benefit of options to retailers (of lower hedging costs) without including their cost.

### **Frontier then suggests an efficient hedging position**

With this range of possible demand conditions, Frontier then estimates the hedging position a prudent retailer would adopt. The hedging position is the level of protection from spot prices, using a combination of hedging contracts, that a retailer selects. To estimate the cost of this hedging position, we asked Frontier to use the 12-month trade-weighted hedging contract prices from ASX Energy for base swap and base cap contracts.

An efficient contracting position was then estimated using Frontier Economics' STRIKE model. The model uses the ASX Energy contract prices, historical spot prices from the Australian Energy Market Operator, and the demand conditions from the Monte Carlo simulations. Using this data, the STRIKE model determines the contracting positions that provide the lowest cost combination of hedging contracts to achieve a very conservative hedging position (one with very little exposure to spot prices).

An amount for holding working capital (cash) to fund spot market purchases was also included – a volatility adjustment which funds shortfalls during periods of very high spot prices (which it would be too costly to hedge against).

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<sup>17</sup> 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).

<sup>18</sup> The assumed contract premium is five per cent on the underlying prices.

## **We have factored network losses into our wholesale cost forecasts**

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

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.

We have used the short sub-transmission factor for the CitiPower, Jemena, and United Energy distribution zones and the load weighted average of the short and long sub-transmission factors for the Powercor and AusNet zones.<sup>19</sup>

In calculating the marginal loss factor, we take a simple average of the relevant regional reference node factor for each distribution zone.<sup>20</sup> We remove some transmission nodes as they do not have any domestic or small business load. We combine these to calculate an adjustment factor which is applied to energy purchase costs, environmental costs, and ancillary charges.

This approach is consistent with the approach we used in the 2023–24 Victorian Default Offer.

## **We propose taking final wholesale contract price readings on the last Friday of April**

To promote transparency and consistency, we propose the last Friday of April (26 April 2024) as the date for taking our final reading of ASX Energy contracts prices for use in our wholesale cost benchmark for the 2024–25 Victorian Default Offer.

## **We considered stakeholder feedback on wholesale costs**

We received 13 submissions on wholesale electricity costs in response to our request for comment paper. Three from consumers, or their advocates, and 10 from retailers and their peak body the Australian Energy Council.

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<sup>19</sup> Australian Energy Market Operator, Distribution Loss Factors for the 2023–24 Financial Year, July 2023, p. 12. We will update network losses in our final decision paper to account for the most recent information.

<sup>20</sup> Australian Energy Market Operator, Preliminary Marginal Loss Factors 2023–24 Financial Year, December 2022, p. 24-25.

In general, submissions from stakeholders supported our approach to wholesale electricity costs. While consumers and their representatives were generally supportive of our approach, they urged us to ensure that our wholesale benchmark reflected retailers' costs.<sup>21</sup>

Retailers and the Australian Energy Council also supported our overall approach to the wholesale benchmark.<sup>22</sup> However, they encouraged us make sure the assumptions in our wholesale cost benchmark remain relevant by monitoring changes in demand and the types of contracts used by retailers. Some retailers were also of the view that we should use over-the-counter contracts to set our wholesale electricity cost benchmark.

### **ASX Energy base contracts are still the most frequently used hedging products**

We made an adjustment to our wholesale cost methodology, to remove peak swap contracts from the forecast ASX Energy contract mix, in our 2023–24 Victorian Default Offer final decision. This was based on our analysis of information we collected from retailers that showed retailers are no longer purchasing Victorian peak swap contracts in meaningful volumes.

We asked for submissions in our request for comment paper from stakeholders on the new instruments and strategies that retailers are using to manage peak wholesale price risk instead of peak swap contracts. In their submissions to our request for comment paper, retailers supported excluding ASX Energy peak swap contracts from our wholesale cost benchmark because peak swaps are rarely used now.<sup>23</sup>

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<sup>21</sup> Brian and Jill Golland, submission to the Essential Services Commission '2024–25 Victorian Default Offer: Request for Comment' December 2023, p.1, Consumer Action Law Centre, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, Joint submission from Victorian Council of Social Service (VCOSS), Brotherhood of St Laurence, Consumer Action Law Centre, Council Of The Ageing Victoria, Energy Consumers Australia, Financial Counselling Victoria Inc, Good Shepherd Australia New Zealand, submission to the Essential Services Commission '2024–25 Victorian Default Offer: Request for Comment' December 2023, p.3

<sup>22</sup> 1<sup>st</sup> Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1, AGL Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1, Australian Energy Council, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, Alinta Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, EnergyAustralia, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p.2, Globird Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1, Momentum Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 3, Origin Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, pp.3-4, Shell Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1-2, Simply Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2

<sup>23</sup> 1<sup>st</sup> Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1, Australian Energy Council, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, EnergyAustralia, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, Globird Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1, Origin Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment'



Retailers supported us examining the types of contracts used in the over-the-counter contract market to assess what types of contracts are being used in place of peak swaps.<sup>24</sup> We used our information gathering powers to collect data on the hedging contracts retailers are using to manage their wholesale price risk. We collected information on hedging contracts covering January 2021 to July 2025 from all retailers in Victoria with more than 10,000 domestic and small business customers.

The data we collected included contracts traded over-the-counter, on ASX Energy and FEX Global. The data shows that the vast majority of contracts traded were flat (or base load) contracts. Peak contracts and other products, apart from options, were infrequently traded even in the over-the-counter market. The contract data also showed that while many smaller retailers relied on over-the-counter contracts, at the industry level ASX Energy contracts were still the most traded contracts in the futures market. In its December 2023 report for the Inquiry into the National Electricity Market the Australian Competition and Consumer Commission made similar findings.<sup>25</sup>

Given that ASX contracts are still the most traded contract type, and that over-the-counter contract prices and volumes are not public information, we will continue to base our wholesale electricity cost benchmark on the use of ASX Energy base swap and base cap contracts.

### **Collecting over-the-counter broker data**

In submissions, several retailers suggested that in future we could collect over the counter-contract data from brokers rather than retailers.<sup>26</sup>

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December 2023, p. 1 and 3, Simply Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2

<sup>24</sup> 1<sup>st</sup> Energy submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1, Australian Energy Council, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, Alinta Energy submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, EnergyAustralia, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, GloBird Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1, Shell Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, Simply Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2.

<sup>25</sup> Australian Competition and Consumer Commission, Inquiry into the National Electricity Market, December 2023, p. 87.

<sup>26</sup> 1<sup>st</sup> Energy submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1, Australian Energy Council, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, Alinta Energy submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, EnergyAustralia, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, GloBird Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1, Shell Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, Simply Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2.

We have explored this option with brokers but not all the brokers we have contacted provide this information as a service. Each broker only services part of the market, so data from a subset of brokers may not be representative of broader trends in the over-the-counter market.

Further, as noted above, we collected wholesale contract data from energy retailers, which included over-the-counter contracts, via compulsory information gathering notices. This data continues to show that ASX Energy futures contracts remain the most common form of hedging instrument used across retailers.

Based on the above, we do not intend to collect over-the-counter contract data from brokers.

### **Our wholesale benchmark accounts for changes in load shape over time**

We have maintained our approach of using the most recent three years of historical half-hourly load data and consider this sample period reflects a reasonable balance by providing an appropriate time series to conduct analysis of wholesale costs, and accounting for more recent changes in patterns of demand. The Australian Energy Council and Shell Energy both raised concerns about how changes in demand are accounted for in our wholesale cost benchmark.<sup>27</sup>

Each year, we collect Manually Read Interval Meter data from the Australian Energy Market Operator. We use this information to monitor historical movements and patterns in demand. Frontier uses this information in its Monte-Carlo simulations for our wholesale benchmark.

We assess the load data and consider what sample will provide the best indication of future years. Where we see evidence that patterns of demand are changing, we consider whether we need to change the sample period, in consultation with stakeholders.

When we first provided advice to the Victorian Government on the Victorian Default Offer, we recommended using the five most recent years of historical data in the Monte-Carlo simulation.<sup>28</sup> However, to account for accelerated changes to patterns of energy use, we now use the three most recent years of data.

We have considered using only one year of load data for our wholesale cost benchmark. While this would mean our forecasts would reflect the most recent patterns of demand, it would also make our forecasts more likely to be affected by one off weather patterns and short-term market dynamics.

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<sup>27</sup> Australian Energy Council, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, Shell Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>28</sup> Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, 3 May 2019, p. 25.

We will continue to monitor changes in demand and change our approach if appropriate.

### **We will consider submissions on unaccounted for energy**

The Australian Energy Council raised concerns about how load shape is affected by unaccounted for Energy (UFE) in our wholesale cost benchmark.<sup>29</sup>

The Australian Energy Market Operator measures the amount of energy that goes into the National Electricity Market and the amount that reaches consumers' meters. Unaccounted for energy is the difference between these two amounts (after accounting for distribution and transmission losses and unmetered but billed usage). Since global settlement began in 2022, the Australian Energy Market Operator has charged all retailers for their share of unaccounted for energy.

We do not have sufficient evidence that unaccounted for energy is material to the setting of the Victorian Default Offer. Based on publicly available information, unaccounted for energy appears to make up less than 1 per cent of total energy dispatched across the Victorian networks.<sup>30</sup> We consider this is immaterial in the context of the Victorian Default Offer. Accordingly, we have not included an adjustment to reflect unaccounted for energy.

### **Our benchmark accounts for self-insurance against wholesale market volatility**

The Australian Energy Council submitted:

The AEC supports and acknowledges the ESC inclusion of a volatility allowance designed to compensate prudent retailers for the costs of holding sufficient working capital to remain financially viable through periods of peak demand and price. The AEC, however, notes that the current VDO methodology does not allow for working capital support for the type of extreme market scenario where, over an extended period of time, demand sits above the swap covered position simultaneous to prices landing above the WEC allowance.<sup>31</sup>

The volatility allowance is designed as to cover the cost of holding working capital to fund cashflow shortfalls that could arise in years when actual wholesale costs are higher than forecast. The amount of working capital is based on the difference between the wholesale electricity costs that we have estimated for the median simulated year and the costs for the most costly simulated year

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<sup>29</sup> Australian Energy Council, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>30</sup> Australian Energy Market Operator, *Unaccounted For Energy (UFE): Trends Report*, Appendix 1, May 2023.

<sup>31</sup> Australian Energy Council, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2.

for each distribution area. In some years, actual costs will be higher than expected, in others it will be lower. But on average over time, we would expect the higher and lower costs to balance out.

This said, the methodology we use means in general we would expect there to be relatively little unhedged load. For example, during the very high spot prices experienced during 2022, we monitored the exposure retailers would face if they had adopted the hedging position assumed in our Victorian Default Offer wholesale cost benchmark. We found that retailers hedged in this way would have had very little unhedged load and therefore little need for working capital to support the extreme market scenario that eventuated.

We acknowledge that some retailers may choose a riskier hedging position than assumed in our wholesale cost benchmark, and therefore have higher working capital requirements. But we are not required to set our cost benchmarks to reflect the actual costs of individual retailers.

Further, those retailers with greater exposure to the wholesale spot price would also spend less on hedging contracts costs. As a result, if we were to increase the volatility allowance we would also have to make a commensurate decrease in hedging contract purchase costs.

### **Interest on working capital is accounted for in the retail operating margin**

Momentum Energy submitted:

*we believe that the substantial rise in interest rates over the past few years has increased the “cost of carry” to fund Australian Stock Exchange (ASX) hedge positions on the ASX. We believe the VDO does not factor in this cost.<sup>32</sup>*

The cost of interest accrued on working capital for margin requirements is covered in the retail operating margin. The retail operating margin is an EBITDA margin, meaning it covers interest, tax, and depreciation costs (as well as a return on equity). Accounting for this cost in both the wholesale benchmark and the retail operating margin would not meet the requirements of the pricing order.<sup>33</sup> Comments from stakeholders on the impact of higher interest rates are addressed in the retail operating margin section.

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<sup>32</sup> Momentum Energy, submission to the Essential Services Commission ‘2024-25 Victorian Default Offer: Request for Comment’ December 2023.

<sup>33</sup> Clauses 12(3) and 12(7) of the pricing order.

## Network costs

- Our draft decision is to continue using a cost pass through approach for network costs.
- For our draft decision on network costs, we have used the indicative network tariffs that Victorian network businesses submitted to the Australian Energy Regulator in February 2024.
- The approved 2024–25 tariffs are not yet available. We will update the network costs for our final decision once the Australian Energy Regulator approves network tariffs.
- Based on the benchmarks we adopt for the Victorian Default Offer, network costs represent about 35 per cent of the average domestic flat tariff bill (averaged across the five distribution zones).
- The network costs in our draft decision are about 6 per cent higher than those incorporated into our 2023–24 Victorian Default Offer determination.

Network costs represent the costs of building, operating and expanding electricity transmission and distribution networks. 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 annually and are paid by electricity retailers for access to transmission and distribution services. We are required to have regard to network costs in estimating efficient costs of electricity retailers.<sup>34</sup>

For all domestic and small business electricity customers, each network tariff consists of three main elements:

- 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 within each jurisdiction.

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<sup>34</sup> Clauses 12(4)(b) of the pricing order.

## **Our draft decision is to keep a cost pass through approach to network costs**

We will use the 2024–25 network tariffs approved by the Australian Energy Regulator for each distribution zone to establish a benchmark for network costs (Appendix B). This cost pass through approach continues to be supported by stakeholders.<sup>35</sup>

For our draft decision on the network costs, we have used the indicative tariffs for 2024–25 that the Victorian network businesses submitted to the Australian Energy Regulator in February, which considers the best estimates and latest cost impacts (for example, adjustments for recovery of revenue in prior years and inflation). While this is currently the best available information, our final decision will use the Australian Energy Regulator approved network tariffs for 2024–25.

Overall, network costs in a Victorian Default Offer bill resulting from our draft decision are higher than they were in the 2023–24 Victorian Default Offer.

## **We have considered stakeholder submissions on network costs**

We received one submission on our approach to determining network costs.<sup>36</sup>

Origin Energy submits that in the event network prices approved by the Australian Energy Regulator are not available to incorporate into the Victorian Default Offer pricing determination, the commission should use the 2024–25 network tariffs submitted for approval by the Victorian networks as the next best alternative.

Origin Energy adds that any differences between the proposed and approved network tariffs should be accounted for by applying a true-up mechanism in future years.

We will remain in contact with the Australian Energy Regulator to help ensure the timing of network tariffs regulation decisions allows their smooth implementation via the Victorian Default Offer.

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<sup>35</sup> Origin Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>36</sup> Origin Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

## Environmental costs

- Our draft decision is to maintain our current approach for estimating costs for the Large-scale Renewable Energy Target, Small-scale Renewable Energy Scheme, Victorian Energy Upgrades program and the minimum feed-in tariff.
- Environmental costs represent about 8 per cent of the average domestic flat Victorian Default Offer bill (averaged across the five distribution zones).
- Our draft decision means environmental costs for domestic customers are 2 per cent higher compared to the amount in our 2023–24 determination. This is mainly driven by increased renewable exports and higher environmental certificate prices.

In line with the pricing order, we are required to have regard to environmental costs when reviewing and setting the Victorian Default Offer.<sup>37</sup> Environmental costs are incurred by Victorian electricity retailers to meet legal obligations imposed by government. As these costs are unavoidable, we include them in the Victorian Default Offer. This helps the Victorian Default Offer reflect retailers' efficient costs of selling electricity.<sup>38</sup>

Environmental costs faced by Victorian electricity retailers relate to the following programs:

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

The amount of environmental costs in our draft decision has increased slightly from the amount included in the 2023–24 Victorian Default Offer for domestic customers.

### Our draft decision maintains our approach to environmental costs

Our draft decision includes benchmarks of environmental costs calculated using mostly public sources. This approach is the same used in previous reviews regarding environmental costs. We update relevant inputs from the 2023–24 Victorian Default Offer benchmarks where available. The draft decision includes more recent certificate prices, customer numbers, renewable export data and some liability percentages.

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<sup>37</sup> Clause 12(4)(c) of the [pricing order](#).

<sup>38</sup> Clause 12(3) of the [pricing order](#).

An average domestic Victorian Default Offer customer will pay \$134 per year in environmental costs out of a total annual bill of \$1,643. This is \$2 higher than the amount included in the 2023–24 Victorian Default Offer cost stack. This change is mainly due to increased solar exports (increasing the cost of feed-in tariff payments) and an increase in the price of Victorian energy efficiency certificates (increasing the cost of complying with the Victorian Energy Upgrades program).

### **Our approach to estimating environmental costs**

The approach we have applied in our draft decision for each environmental cost is explained below.

- Large-scale Renewable Energy Target:
  - the 2023 renewable power percentage (liability percentage) is multiplied by the 2024–25 forward market price for large-scale generation certificates.<sup>39</sup>
- Small-scale Renewable Energy Scheme:
  - the mid-point between the 2024 non-binding and the 2025 non-binding small-scale technology percentage (liability percentage) is multiplied by the clearing house price for small-scale technology certificates.<sup>40 41</sup>
- Victorian Energy Upgrades program:
  - the recent 12-month trade-weighted average spot price for Victorian energy efficiency certificates (VEECs) is multiplied by the 2024 greenhouse gas reduction rate.<sup>42</sup>

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<sup>39</sup> The Clean Energy Regulator sets the renewable power percentage for each calendar year, this determines the amount of large-scale generation certificates liable entities must surrender to meet their obligations. The 2024 liability percentage was not determined in time for our draft decision. The Clean Energy Regulator must set the renewable power percentage for each calendar year by 31 March, or a default renewable power percentage will apply. Clean Energy Regulator, <https://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-renewable-power-percentage>, accessed 23 January 2024.

<sup>40</sup> The STC clearing house is operated by the Clean Energy Regulator and has a fixed price of \$40 (excluding GST) per small-scale technology certificate (STC). STC's can be sold through the open market for an uncapped price or through the STC clearing house for a fixed price. Clean Energy Regulator, <https://www.cleanenergyregulator.gov.au/OSR/REC/STC-clearing-house>, accessed 23 January 2024.

<sup>41</sup> The Clean Energy Regulator sets a binding small-scale technology percentage for each calendar year and a non-binding percentage for two future years. This determines the amount of small-scale technology certificates liable entities must surrender to meet their obligations. The 2024 binding liability percentage was not determined in time for our draft decision. The Clean Energy Regulator must set the small-scale technology percentage for each calendar year by 31 March, or a default renewable power percentage will apply. Clean Energy Regulator, <https://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-small-scale-technology-percentage>, accessed 23 January 2024.

<sup>42</sup> 12-month period is from 1 January 2023 to 26 December 2023. Greenhouse gas reduction rate for electricity in 2024 is 0.15244. Essential Services Commission, <https://www.esc.vic.gov.au/victorian-energy-upgrades-program/participating-veu-program/energy-retailers-veu-program>, accessed 23 January 2024.



The above costs are multiplied by the network loss factors.

- Social cost of carbon applied to the minimum feed-in tariff:
  - Total renewable exports for the most recent complete financial year are multiplied by the social cost of carbon (2.5 cents per kilowatt hour for 2024–25).
  - This amount is then divided by the average number of domestic and small business customers for the same period.

Our final decision will include an update to the data used to estimate the environmental costs in this draft decision. Our final decision will follow our previous approach to estimating the cost of complying with the Large-scale Renewable Energy Target and Small-scale Renewable Energy Scheme, which will include a true-up for more up-to date information. Our final decision will include more recent:

- forward market price for large-scale generation certificates
- liability percentages
- trade-weighted average spot price for VEECs
- renewable export data and customer numbers.

### **Stakeholders support our approach to environmental costs**

Overall, the submissions we received in response to our request for comment paper were supportive of our approach to environmental costs in the Victorian Default Offer.<sup>43</sup> Electricity retailers are required to comply with federal and state environmental programs and incur costs as a result.

Shell Energy queried how a new activity in the Victorian Energy Upgrades program, and the Victorian Government's wider Gas Substitution Roadmap, would impact the Victorian Default Offer.<sup>44</sup> We estimate and include costs associated with the Victorian Energy Upgrades program in the Victorian Default Offer and additional activity would impact the certificate price and/or volumes of certificates traded which are accounted for in our methodology. Electrification initiatives would change demand for electricity. Our approach to wholesale electricity costs accounts for changes in demand over time by using the most recent three years of load data.

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<sup>43</sup> Origin Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>44</sup> Shell Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

## Our draft decision is to keep our approach to Large-scale Renewable Energy Target costs

The Large-scale Renewable Energy Target (LRET) is an Australian Government policy designed to reduce emissions in the electricity sector and encourage additional generation from renewable sources. It creates a financial incentive for the installation of large-scale renewable energy power stations.

Under the policy, eligible power stations create large-scale generation certificates (LGCs) for every megawatt hour of renewable power they generate. Electricity retailers buy LGCs to meet their legally binding Renewable Energy Target obligations, this is done on an open market. The Clean Energy Regulator sets a target for renewable electricity to be generated each year, that target is now constant at 33,000,000 MWh to 2030.<sup>45</sup> Annual renewable generation targets and the amount of wholesale electricity purchased by electricity retailers determine the renewable power percentage (liability percentage). Electricity retailers are required to buy and surrender LGCs to the Clean Energy Regulator each year based on the liability percentage.

Our draft decision uses a similar approach to calculating the cost of complying with the LRET as previous decisions. Using publicly available information on future market prices for LGCs is a transparent and replicable method to estimating the efficient cost of the LRET program.<sup>46</sup>

To estimate the per megawatt benchmark cost for the LRET we start with the 2023 liability percentage of 18.96 per cent.<sup>47</sup> We then multiply the liability percentage by the average future market price for 2024–25 LGCs.<sup>48</sup>

The 2024 liability percentage was unavailable to be included in our draft decision. We expect it will be included in our final decision. Without the 2024 liability percentage, we are unable to perform a true-up in this draft decision. A true-up accounts for the difference between the liability percentage used in our 2023–24 final decision and the actual liability percentage for 2023–24. We expect to include this adjustment in our final decision.

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<sup>45</sup> The Clean Energy Regulator has set the renewable energy target at 33,000,000 megawatt hours since 2021, <https://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-renewable-power-percentage#Annual-targets-and-renewable-power-percentages>, accessed 22 January 2024.

<sup>46</sup> Essential Services Commission, *Victorian Default Offer 2021: Final Decision*, 25 November 2020, pp. 23–26.

<sup>47</sup> Clean Energy Regulator set the renewable power percentage at 18.96 per cent for 2023. Clean Energy Regulator <https://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-renewable-power-percentage>, accessed 22 January 2024.

<sup>48</sup> We have used the most recent 12-months of average future market prices for 2024–25 LGCs. Frontier Economics, *Wholesale electricity costs for 2024–25: A draft report for the Essential Services Commission*, February 2024 p. 44

Our draft decision for domestic and small business Victorian Default Offer customers, regarding the cost of compliance with the LRET for 2024–25, is \$9.17 per megawatt hour.

Our final decision will include more recent trade-weighted prices for LGCs, the 2024 liability percentage as well as a true-up to account for the difference in liability percentages between 2023 and the mid-point for 2023–24.

### **Our draft decision is to keep our approach to the Small-scale Renewable Energy Scheme**

The Small-scale Renewable Energy Scheme (SRES) places an obligation on electricity retailers to purchase small-scale renewable technology certificates (STCs). Under the scheme, individuals and small businesses that install eligible small-scale renewable energy systems such as solar panels, solar hot water systems and air source heat pumps create STCs.<sup>49</sup> These STCs can then be sold to electricity retailers.

By March each year the Clean Energy Regulator sets a binding small-scale technology percentage (binding liability percentage) for the current year, and non-binding small-scale technology percentage (non-binding liability percentage) for future years.<sup>50</sup> These liability percentages set or estimate the amount of STCs electricity retailers must buy. Electricity retailers must then surrender STCs, based on the liability percentage, to meet their obligation under the SRES for that year.

Our draft decision is to use a similar approach to calculate the cost of the SRES as we used in previous Victorian Default Offer decisions. The 2024 binding liability percentage was not available to be included in our draft decision, so we have used the 2024 non-binding liability percentage. This means we have not performed a true-up in this draft decision. Without the 2024 binding liability percentage we are not able to determine the actual midpoint liability for 2023–24. Once the 2024 liability percentage is known we can then account for any difference between the actual and the estimated liability used in our 2023–24 final decision. This true-up is expected to be performed in our final decision.

For our draft decision we used the mid-point between the 2024 non-binding and 2025 non-binding liability percentages, multiplied by the STC clearing house price (\$40 excluding GST).<sup>51</sup> Our draft

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<sup>49</sup> For more information see <https://www.cleanenergyregulator.gov.au/RET/About-the-Renewable-Energy-Target/How-the-scheme-works/Small-scale-Renewable-Energy-Scheme>, accessed 23 January 2024.

<sup>50</sup> Clean Energy Regulator, <https://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-small-scale-technology-percentage>, accessed 22 January 2024.

<sup>51</sup> Small-scale renewable energy system owners and registered agents have the option to sell STCs through the open market for an uncapped price, or through the STC clearing house at a fixed price of \$40 (excluding GST). Clean Energy Regulator, <https://www.cleanenergyregulator.gov.au/OSR/REC/STC-clearing-house>, accessed 22 January 2024.

decision uses a mid-point of 16.39 per cent, using the 2024 non-binding percentage of 17.99 and the 2025 non-binding percentage of 14.79.

Our draft decision for domestic and small business Victorian Default Offer customers, regarding the cost of compliance with the SRES for 2024–25, is \$6.56 per megawatt hour. This is an increase of \$1.20 per megawatt hour from our 2023–24 Victorian Default Offer because our previous determination included a negative true-up value of \$1.49.

Our final decision will include the 2024 binding liability percentage, multiplied by the known price of small-scale technology certificates. We will also include a true-up to account for the difference between the midpoint liability percentage used in the final 2023–24 final decision and the actual midpoint for 2023–24. We expect the 2024 liability percentage to be known when we make our final decision.

### **Our draft decision is to keep our approach to the Victorian Energy Upgrades costs**

The Victorian Energy Upgrades program is a key mechanism in reducing greenhouse gas emissions in Victoria and the largest energy efficiency program in Australia.<sup>52</sup>

The program aims to deliver greenhouse gas emission reductions, while helping Victorians reduce their energy costs. Under the program, accredited persons perform energy upgrades to create Victorian energy efficiency certificates (VEECs), which can lead to discounted energy efficient products for Victorians.

Each VEEC represents one tonne of carbon dioxide equivalent of greenhouse gas avoided. Electricity retailers must buy and surrender VEECs to meet their obligations set in Victorian legislation.

Our draft decision is to keep our approach to calculating the cost of the Victorian Energy Upgrades program for electricity retailers the same as in previous decisions. We use the most recent 12-months trade-weighted average spot price for VEECs multiplied by the 2024 greenhouse gas reduction rate for electricity.<sup>53</sup>

Using an average trade-weighted certificate price of \$77.15 excluding GST, multiplied by the 2024 greenhouse gas reduction rate of 0.15244 means the cost incurred to comply with the Victorian Energy Upgrades program for a domestic Victorian Default Offer customer is \$11.76 per megawatt hour. This is an increase of 58 cents from \$11.18 per megawatt hour in our 2023–24 Victorian

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<sup>52</sup> Essential Services Commission, *Victorian Energy Upgrades Performance Report 2022*, September 2023, p. 2

<sup>53</sup> From 1 January 2023 to 26 December 2023. Greenhouse gas reduction rate for 2024 is 0.15244. Essential Services Commission, <https://www.esc.vic.gov.au/victorian-energy-upgrades-program/participating-veu-program/energy-retailers-veu-program>, accessed 23 January 2024.

Default Offer. Whilst the 2024 greenhouse gas reduction rate is lower than in our 2023–24 Default Offer this increase is due to the increase in the average trade-weighted certificate price.

Our final decision will include more recent trade-weighted average prices for VEECs, and as result may differ from our draft decision.

### **Our draft decision is to keep our approach to the cost of the minimum feed-in tariff**

The minimum feed-in tariff is the minimum rate electricity retailers must pay solar customers for electricity exported to the grid. The commission reviews and sets this amount each year. The feed-in tariff includes a payment for the avoided social cost of carbon which is the value of carbon emissions that are avoided when energy is sourced from small-scale renewable generators, like roof-top solar. The Victorian Government has set the social cost of carbon at 2.5 cents per kilowatt hour.<sup>54 55</sup>

When small-scale renewable generators, like rooftop solar owners, export energy to the grid retailers must pay them the avoided social cost of carbon in addition to the wholesale price of electricity. All factors that make up the minimum feed-in tariff, except the avoided social cost of carbon, are accounted for elsewhere when we estimate the Victorian Default Offer cost benchmarks. However, electricity retailers are required to pay small-scale renewable generators for this additional social benefit. As a result, we include the avoided social cost of carbon in the Victorian Default Offer.

Our draft decision is to keep our approach to calculating the cost of the minimum feed-in tariff the same as in previous decisions. To estimate this cost incurred by electricity retailers, we multiply the total renewable exports for the 2022–23 financial year by the social cost of carbon. The resulting amount is then divided by the total average number of domestic and small business customers over the same period.

Our draft decision for domestic and small business Victorian Default Offer customers, regarding the cost of the minimum feed-in tariff for 2024–25, is \$17.70 per customer per year. This is an increase of 75 cents from our 2023–24 Victorian Default Offer determination of \$16.95 per customer per year. This is due to the increase in the amount of renewable energy exported to the grid.

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<sup>54</sup> Order specifying a methodology and factors for the determination of the avoided social cost of carbon. Victorian Government 2017, *Victoria Government Gazette No. S 36*, Tuesday 21 February 2017.

<sup>55</sup> Essential Services Commission calculation, *Minimum Feed-in Tariff rates to apply from 1 July 2024 draft decision*, 22 November 2023 p. 38-39.

Our final decision will include updated renewable energy export and customer number data. As a result, it may differ from our draft decision.

## Retail operating costs

- Our draft decision is to continue setting the retail operating cost benchmark using the customer-weighted average of retailers' actual retail operating costs. This approach was first adopted for our 2023–24 Victorian Default Offer decision.
- Retail operating costs represent about 9 per cent of the average domestic flat tariff bill (averaged across the five distribution zones).
- The retail operating costs in our draft decision are about 8 per cent higher than the amount included in our 2023–24 Victorian Default Offer determination.

Retail operating costs consist of a range of costs incurred by an electricity retailer, including:

- billing and revenue collection systems
- information technology systems
- call centre costs
- corporate overheads
- energy trading costs
- bad and doubtful debt write-offs
- regulatory compliance costs.

The pricing order requires us to have regard to efficient retail operating costs in determining the efficient costs of the sale of retail electricity.<sup>56</sup>

For our 2023–24 decision, we set the retail operating cost benchmark based on the customer-weighted average of retailers' actual retail operating costs.<sup>57</sup>

### **Our draft decision is to use a benchmark based on retailers' cost data**

Our draft decision is to continue with a benchmarking approach for retail operating costs based on retailers' actual costs.

The cost data shows that retailers' retail operating costs increased by about eight per cent between 2021–22 and 2022–23 when adjusted for inflation.

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<sup>56</sup> Clause 12(4)(d) of the pricing order.

<sup>57</sup> Essential Services Commission 2023, Victorian Default Offer 2023-24: Final Decision Paper, 25 May.

The data collected reflects the most up-to-date cost information available, incorporating any productivity improvements and changes in regulatory obligations. Therefore, basing our benchmark on the customer weighted average of retailers' actual costs will ensure our price determination enables retailers to recover the efficient costs of the sale of electricity from Victorian Default Offer customers.

### **Stakeholders made a number of comments on the retail cost benchmark**

We received three submissions on our approach to retail operating costs.

Origin Energy expressed its support for the commission using retail operating costs and bad and doubtful debts data collected via our own data collection process given consistency with those reported to the Australian Competition and Consumer Commission by retailers.<sup>58</sup>

Simply Energy was of the view that a customer-weighted average retail operating cost benchmark does not accurately reflect retailer's efficient costs. It submitted that it introduces a bias in the estimate towards the operating costs of the three major retailers.<sup>59</sup> Simply Energy stated that the three major retailers have access to significant advantages over smaller retailers and urged us to consider a benchmark based on a median or mean measurement to promote market competition. The Australian Energy Council (AEC) also encouraged us to continue to monitor the retail operating costs reasonably expected for a start-up and a prudent tier 2 retailer for comparison against the customer-weighted cost estimate.<sup>60</sup>

The pricing order requires us to base the Victorian Default Offer tariffs on the efficient costs of the sale of electricity and not on the actual costs of a retailer.<sup>61</sup> Our approach is to consider the costs faced by a sample of retailers that are representative of the broader Victorian retail electricity industry. We note that there are several retailers of different sizes that have retail operating costs below our benchmark. Nonetheless, we will continue to monitor where the retailers' costs sit relative to the retail operating cost benchmark.

The AEC encouraged us to monitor the impact of bad debt write-offs on our retail cost benchmark. The AEC raised concerns that small customers may cross-subsidise larger customers as tariffs

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<sup>58</sup> Origin Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>59</sup> Simply Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>60</sup> Australian Energy Council, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>61</sup> Clause 12, subclauses 3 and 8 of the pricing order.

increase.<sup>62</sup> The AEC then suggested that this issue could be avoided if the allowance for bad debts were made a proportion of the total cost stack (instead of a fixed cost in retail operating costs as is currently the case).

The validity of this cross-subsidisation concern rests on the assumption that default risk increases with bill size. We encourage the AEC, or other retailers, to provide us with information to support this view. For the time being, we propose to make no change as to where bad debt costs are accounted for. Further bad debt costs make up a relatively small share of total costs. But we will continue to monitor retailers' bad debt costs.

## Customer acquisition and retention costs

- Our draft decision is to keep the same approach we have used in past reviews to estimate customer acquisition and retention costs (acquisition costs).
- Acquisition costs represent about 3 per cent of the average domestic bill (averaged across the five distribution zones).
- Due to inflation, acquisition costs in the cost stack have slightly increased compared to those in the 2023–24 Victorian Default Offer.

The pricing order requires us to determine the amount of modest costs of customer acquisition and retention (acquisition costs) in making our Victorian Default Offer price determinations.<sup>63</sup> In our view these include:

- The cost of customer acquisition channels (such as third-party comparison websites or telemarketing).
- The cost of customer retention teams.
- Marketing costs targeted at driving customer acquisition or retention.

### Our draft decision is to keep our approach to estimating acquisition costs

For our draft decision we used an acquisition cost benchmark based on the average NEM-wide acquisition costs from the Australian Competition and Consumer Commission's (ACCC) retail electricity pricing inquiry report.<sup>64</sup> We selected average costs from 2013–14 on the basis that it was

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<sup>62</sup> Australian Energy Council, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>63</sup> Clause 12(4)(d) and Clause 12(6) of the pricing order.

<sup>64</sup> Australian Competition and Consumer Commission, Retail electricity pricing inquiry – Final report July 2018, p. 222.



the most robust data available prior to large increases in spending on acquisition costs observed across most jurisdictions.

We have updated our acquisition cost benchmark for inflation during each Victorian Default Offer review.<sup>65</sup> In adjusting for inflation, we are maintaining the value of our benchmark in real terms over time. This approach results in a modest benchmark for acquisition costs of \$45.05 excluding GST: slightly higher than the benchmark of \$43.89 for the 2023–24 Victorian Default Offer.

### **We have considered stakeholder submissions on acquisition costs**

We received submissions on our approach to acquisition costs from seven community sector organisations and energy consumer advocates.<sup>66 67</sup>

They were of the view that it is unfair to expect Victorian Default Offer customers and customers on embedded networks to pay for acquisition costs. The submissions accepted that we must determine the amount of modest acquisition costs in the Victorian Default Offer, but suggested we provide advice to the Minister for Energy to remove acquisition costs from costs we must have regard to in setting Default Offer prices.

It is true that retailers do not incur acquisition costs for embedded network customers and are unlikely to incur acquisition costs for disengaged customers. However, the role of the Victorian Default Offer is not limited to protecting these customers. The Victorian Default Offer also acts as a reference price, and it is available to any customer that asks for it.

We consider that given the Victorian Default Offer is intended to reflect efficient costs and is used as a reference price for market offers it should include an amount for customer acquisition and retention costs. These costs are borne by retailers operating in a contestable retail market. This approach is consistent with the initial advice we provided to the Victorian government in 2019.<sup>68</sup>

Accordingly, we do not intend to advise government to remove customer acquisition and retention costs from the pricing order. Any decision to change the pricing order is a matter for policymakers.

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<sup>65</sup> 31 December 2023 [Australian Bureau of Statistics](#), All groups CPI, Australia Series ID A2325846C, accessed 8 March 2024

<sup>66</sup> Consumer Action Law Centre, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>67</sup> Joint submission from Victorian Council of Social Service (VCOSS), Brotherhood of St Laurence, Consumer Action Law Centre, Council Of The Ageing Victoria, Energy Consumers Australia, Financial Counselling Victoria Inc, Good Shepherd Australia New Zealand, submission to the Essential Services Commission '2024–25 Victorian Default Offer: Request for Comment' December 2023.

<sup>68</sup> Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, 3 May.

In terms of our approach to establishing a modest allowance for customer acquisition and retention cost, we note a recent review of the Victorian Default Offer pricing order found our interpretation of the term 'modest' appears to balance stakeholder interests.<sup>69</sup>

## Other costs

- Our draft decision is to set a benchmark for other regulatory costs that are based on the latest available market information. These costs include:
  - market intervention costs
  - Australian Energy Market Operator fees
  - ancillary fees
  - Reliability and Emergency Reserve Trader costs
  - Essential Services Commission licence fees.
- Other costs make up around slightly less than one per cent of total costs for a representative customer (averaged across the five distribution zones).
- Our draft decision would marginally decrease the amount included for these costs compared with the 2023–24 Victorian Default Offer primarily due to lower market intervention costs and ancillary service fees.

This section outlines other costs which electricity retailers incur that are specific and discrete to their obligations and requirements to operate as an electricity retailer. These costs 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 cost of the sale of electricity by a retailer.<sup>70</sup>

Our draft decision is to pass through these other costs that electricity retailers incur in keeping with the approach to estimating these costs as we have used in previous decisions. These costs include:

- Market intervention costs
- Australian Energy Market Operator fees
- Ancillary fees

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<sup>69</sup> Department of Environment, Land, Water and Planning 2022, Review of the Victorian Default Offer Order in Council Final decision, p. 26-27.

<sup>70</sup> Clause 12(4)(f) of the [pricing order](#).

- Reliability and Emergency Reserve Trader costs
- Essential Services Commission licence fees.

### **Retailers should be able to recover market suspension costs**

The Australian Energy Market Operator (market operator) manages the power system that supports the National Electricity Market (NEM). If the power system is interrupted the market operator can act to maintain a secure operating state by suspending the NEM. In the event the NEM is suspended, the cost of electricity traded on the NEM during that time is determined through market suspension pricing schedules set out in the National Electricity Rules.<sup>71</sup> This cost is recovered by the market operator from electricity retailers contributing to electricity demand during the suspension event.

Two short events occurred in 2023 that required the market operator to temporarily suspend the NEM due to system outages.<sup>72</sup> Both events resulted in market suspension pricing to apply, and the market operator recovers this cost through Victorian electricity retailers. As these events, and subsequent costs, are unavoidable for Victorian electricity retailers we include known costs in our Victorian Default Offer cost benchmarks.

We have received values from the market operator of the costs incurred due to these two short market suspension events. We understand a finalised report will be published by the market operator in the coming months.

Our draft decision is to include known market intervention costs to reflect the cost incurred by Victorian electricity retailers. This is consistent with the requirement in the pricing order to base Victorian Default Offer prices on efficient costs.<sup>73</sup> Our draft decision calculates this by dividing the known market intervention costs by the 2023–24 forecast electricity usage for Victorian customers.<sup>74</sup>

Our draft decision for the average domestic Default Offer customer includes \$0.0033 per megawatt hour to account for market suspension costs. Our final decision will include any changes or

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<sup>71</sup> For more information see: [AEMC National Electricity Rules - Rule 3.14 Administered Price Cap and Market Suspension](#). Accessed 24 January 2024.

<sup>72</sup> The National Energy Market was suspended in Victoria for approximately 12.25 hours over 22–23 April 2023, [Preliminary report: Victoria market suspension on 22 April 2023](#), accessed 8 March 2024. The National Energy Market was suspended in New South Wales for approximately one hour on 17 March 2023, [Final Report: New South Wales market suspension on 17 March 2023](#), accessed 8 March 2024.

<sup>73</sup> Clause 12(3) and 12(4)(f) of the pricing order.

<sup>74</sup> Finalised value confirmed by the Australian Energy Market Operator by email on 22 January 2024.

additional known costs known as of the last Friday of April (26 April 2024) which are incurred due to market suspension.

### **Market intervention costs resulting from June 2022 event**

Wholesale electricity prices increased significantly in the first half of 2022. Following this, the Australian Energy Market Operator took temporary steps to stabilise the market in June 2022. These included introducing an Administered Price Cap on wholesale electricity prices, suspending the wholesale market, and directing generators to supply as required.<sup>75</sup> Electricity generators incurred costs because of these actions.

Electricity generators who were financially disadvantaged during these events can make compensation claims. If the claims are successful, the value of the costs successfully claimed are then passed on to electricity retailers. The process for these claims is set out in the National Energy Rules.<sup>76</sup>

When we made our last decision, the Australian Energy Market Commission had not completed its assessment of all administered pricing claims for 2022.<sup>77</sup>

The value of the outstanding claims for compensation is not known at this stage. The Australian Energy Market Commission intends to make a final decision on the claims by May 2024.

We will include any administered pricing compensation amounts that are to be recovered from Victorian electricity retailers and determined before the last Friday of April (26 April 2024). If the claims are decided on after this, the amounts will be included in our next review on the Victorian Default Offer.

### **Reliability and Emergency Reserve Trader costs**

The Reliability and Emergency Reserve Trader scheme is a mechanism that the Australian Energy Market Operator can use to maintain power system reliability and system security using reserve contracts. The market operator publishes reports detailing when their reliability and emergency trader functions have been activated.<sup>78</sup>

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<sup>75</sup> For more information on the June 2022 market event see: [AEMO Guide to Market Suspension in the NEM](#).

<sup>76</sup> For more information see: [AEMC National Electricity Rules - Rule 3.14 Administered Price Cap and Market Suspension](#). Accessed 24 January 2024.

<sup>77</sup> For more information see: [AEMC Administered pricing compensation claims relating to June 2022 event](#), accessed 16 February 2024.

<sup>78</sup> Australian Energy Market Operator, [RERT reporting](#), accessed 19 February 2024.

The market operator has entered into three Interim Reliability Reserve (IRR) contracts in Victoria for the duration of 1 December 2023 to 31 March 2024.<sup>79</sup> At the time of making our draft decision we were aware that some costs had been incurred by Victorian energy retailers in December 2023 as a result of these IRR contracts.<sup>80</sup> These costs have not been included in this draft decision but will be included in our final decision, subject to their confirmation with the market operator.

### Australian Energy Market Operator fees

Fees are charged to electricity retailers by the Australian Energy Market Operator (market operator) to recover the costs of market operation.<sup>81</sup> We include a range of charges and fees that the market operator allocates to market participants (electricity retailers). These include:

- general National Energy Market (NEM) fees
- Distributed Energy Resources Integration Program costs
- IT and 5MS/GC compliance costs
- Energy Consumers Australia fees
- Electricity Retail Market fee (formally the Full Retail Contestability operations fee).

Our approach to market operator fees is to include these costs when determining the Victorian Default Offer as these are unavoidable costs incurred by electricity retailers when selling electricity. We consider market operator fees are a relevant factor in our estimation of the efficient cost of the sale of electricity by a retailer.<sup>82</sup> Our draft decision estimate of market operator fees is based on the market operator's final 2023–24 budget and fees. General NEM fees will increase by 4.5 per cent in 2024–25 to follow the market operator's planned fee pathway.<sup>83 84</sup>

The total cost in our draft decision for market operator fees for the average domestic Default Offer customer is \$10.43. This is an increase of 45 cents from \$9.98 in our final 2023–24 decision. This

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<sup>79</sup> [Australian Energy Market Operator, Reliability and Emergency Reserve Trader Quarterly Report Q4 2023](#), accessed 19 February 2024.

<sup>80</sup> [Australian Energy Market Operator, Reliability and Emergency Reserve Trader Quarterly Report Q4 2023](#), accessed 19 February 2024.

<sup>81</sup> For more information on the Australian Energy Market Operators core functions and responsibilities see: [Energy market fees and charges](#), accessed 16 January 2024.

<sup>82</sup> Clause 12(3) and 12(4)(f) of the [pricing order](#).

<sup>83</sup> Australian Energy Market Operator, [Budget and fees: FY24](#), 26 June 2023, p.7, 9 and 25, accessed 16 January 2024.

<sup>84</sup> The Australian Energy Market Operator rebalanced their tariffs in 2021 and a transition period was in place, with the final structure effective from 1 July 2023 to 30 June 2026. This introduced a fixed charge and reduced the variable charge for market participants. For more information on the change to Electricity Fee Structures see Australian Energy Market Operator, [Electricity Fee Structures Final Report and Determination](#), March 2021, accessed 26 January 2024.

increase is due to the market operators planned increase in general NEM fees and an increase in their Electricity Retail Market fee between their draft and approved budget.<sup>85</sup>

### 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.<sup>86</sup> The market operator provides these ancillary services separately for each market region that they operate. Unlike other charges, the market operator's ancillary service fees differ across these different market regions, and so are not included in the Australian Energy Market fees.

The relevant charges depend on the amount of service required at any time, which means the costs will vary from period to period. To estimate Victorian ancillary charges, we used an average of the past 52 weeks (ending 29 December 2023) of ancillary service payments in Victoria. Our draft decision results in an average ancillary service payment of \$0.37 per megawatt hour for the average domestic Victorian Default Offer customer. This is a decrease of 11 cents per megawatt hour from the 2023–24 Victorian Default Offer determination.

Our final decision will be updated to include a more recent 52-week period.

### Essential Services Commission licence fees

Electricity retailers are charged an annual licence fee by the Essential Services Commission 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.

For our draft decision, we used a market wide total of all retailer licence fees for 2023–24, adjusted for inflation, divided by the total number of customers as of 30 June 2023 to estimate the cost of licence fees per customer for the 2024–25 Victorian Default Offer. The latest approved licence fees are for 2023–24. When adjusted by inflation this results in a benchmark of \$2.27 per customer per year for our 2024–25 draft decision. This is an increase of \$0.01 per customer from \$2.26 in our 2023–24 Victorian Default Offer determination due to using more recent licence fees, customer numbers and changes in inflation.

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<sup>85</sup> Approved Electricity retail market fee for FY24 includes \$2.33m relating to Consumer Data Right. Australian Energy Market Operator, [Draft FY24 Budget and Fees](#), April 2023 page 28. Australian Energy Market Operator, Budget and Fees: FY24, June 2023 page 27.

<sup>86</sup> For more information on ancillary services see: Australian Energy Market Operator, [Ancillary Services Payments and Recovery](#), accessed 11 December 2023.

## Retail operating margin

- Our draft decision is to continue to use the retail operating margin benchmark we used in our last Victorian Default Offer decision.
- The retail operating margin is 5.3 per cent of other costs for Victorian Default Offer customers (before GST).
- Our draft decision means that the dollar value of the retail operating margin in the domestic cost stack will decrease by 7 per cent (on average across Victoria's five distribution zones) relative to the amount in the 2023–24 Victorian Default Offer.

The retail margin for an electricity retail business represents the return that a retailer requires to attract the capital needed to provide a retail service.<sup>87</sup>

Under the pricing order we are required to have regard to the retail margin when making a Victorian Default Offer pricing determination.<sup>88</sup> We are not required to base the retail operating margin on retailers' actual operating margins.<sup>89</sup> 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.<sup>90</sup>

### We propose to keep the margin at 5.3 per cent

Our draft decision is to keep using a regulatory benchmarking approach to setting the retail margin and keep the margin at 5.3 per cent.<sup>91</sup> To ensure 5.3 per cent is still an appropriate margin we have considered the following factors:

- Margins set by other Australian regulators
- Market offer prices relative to default offer prices
- The expected returns approach
- Retailers' actual margins

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<sup>87</sup> Australian Energy Market Commission, Advice on Best Practice Retail Price Regulation Methodology, September 2013, page 64.

<sup>88</sup> Clause 12(4)(e) of the pricing order.

<sup>89</sup> Clause 12(9) of the pricing order.

<sup>90</sup> Clause 12(7) of the pricing order.

<sup>91</sup> Our final decision for 2023-24 set the retail operating benchmark at 5.3 per cent. It was previously 5.7 per cent. We note the difference between these benchmark rates (based on the cost stack estimated in this draft decision) is equivalent to around \$6 in the overall cost stack.

- Stakeholder submissions.

## Most Australian jurisdictions maintained their retail operating margin

As part of this review, we investigated the retail margins adopted in other Australian jurisdictions for 2024–25. Our current margin of 5.3 per cent is around the retail operating margins set by other regulators (Table 2).<sup>92</sup>

**Table 2: comparison of regulated retail margins in Australia**

Regulator	Approach	2022–23	2023–24 <sup>93</sup>
Independent Competition and Regulator Commission (ICRC)	The ICRC uses expected returns and regulatory benchmarking approach to set the margin. <sup>94</sup>	5.3%	5.2%
Office of the Tasmanian Economic Regulator	Margin was set at 5.25% of approved costs in 2022-23. <sup>95</sup> The fixed dollar amount of \$100.90 was escalated by the Hobart Consumer Price Index to give a 2023–24 dollar amount of \$108.38 per customer. <sup>96</sup>	5.25%	\$108.38 (approximately 5.25%)
Queensland Competition Authority (QCA)	Not explicitly determined. We have calculated an implied margin for the QCA. The QCA sets an overall retail cost allowance, which is recovered through fixed and variable charges.	3.9%	6.7%

<sup>92</sup> We have not included Australian Energy Regulator’s decision on retail margin in our benchmark. AER’s retail allowance include retail margin as well as headroom for competition to ensure that retailers with higher-than-average cost are still able to compete in the market and make reasonable profits. The approach is set out on page 39 of Default Market Offer prices, final determination, 2023-24

<https://www.aer.gov.au/system/files/Default%20market%20offer%20prices%202023-24%20final%20determination.pdf>

<sup>93</sup> In 2022 OTTER adopted a fixed value per customer for retail margin and indexed it by CPI in 2023-24.

<sup>94</sup> Independent Competition and Regulatory Commission, Retail electricity price investigation 2024-27, January 2024, p. 31.

<sup>95</sup> Office of the Tasmanian Economic Regulator, 2022 standing offer electricity pricing investigation, April 2022, p. 44.

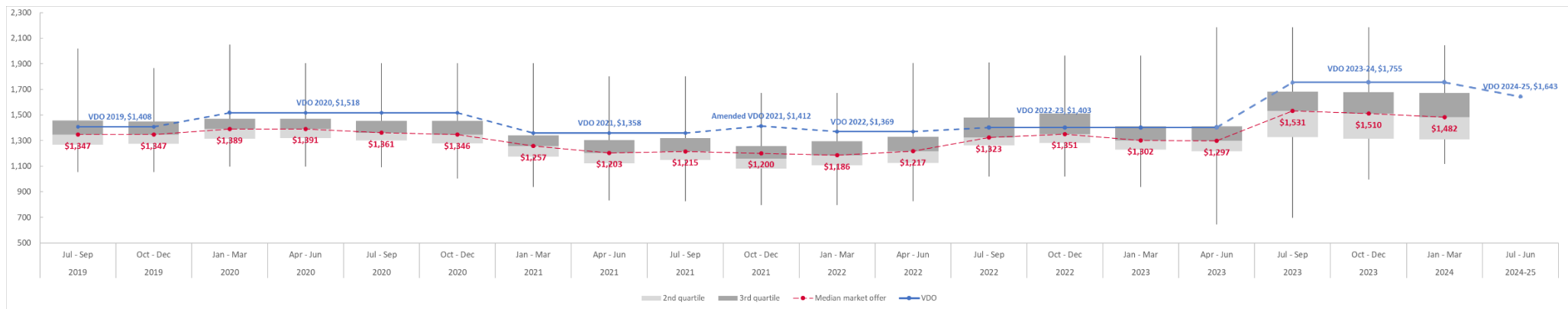
<sup>96</sup> Aurora energy, Pricing Proposal for period 2 of the 2022 standing offer price determination, May 2023, p. 6.



### **There continues to be many market offers priced below the Victorian Default Offer**

Using Victorian Energy Compare data, we have been able to compare market offer prices and Victorian Default Offer prices between 2019 and 2023. Since 2020, more than three quarters of market offers have been below the Victorian Default Offer. This can be seen in figure 4 below. In general, the prices consumers have paid retailers have been below the Victorian Default Offer prices.

**Figure 4: Comparison of Victorian Default Offer and market offer prices for each quarter between July 2019 and March 2024<sup>97</sup>**



Source: Victorian Energy Compare Data and ESC Analysis

<sup>97</sup> The market offer prices were extracted on 31 December 2023.

## **We considered estimates of retailers' actual margins**

We have considered retailer's actual operating margins to cross check our decision on the benchmark retail operating margin for 2024-25. Based on revenue and cost data we collected from retailers using our compulsory information gathering powers, retailers weighted average EBITDA margins in 2021–22 and 2022–23 are lower than the benchmark we have adopted in this draft decision.<sup>98</sup>

We also had regard to actual retail operating margins calculated by Australian Competition and Consumer Commission's as part of the inquiry into the electricity market. The report suggests that actual retail margin in Victoria averaged 5.2 per cent, which roughly aligns with our benchmark margin. The average operating margin across the National Electricity Market region was 2.3 per cent, suggesting our benchmark retail margin is sufficient. Retailers' actual margins estimated by the Australian Competition and Consumer Commission across jurisdictions are listed below.<sup>99</sup>

- National Energy Market: 2.3%
- Victoria: 5.2%
- New South Wales: - 0.7%
- South Australia: 4.5%
- South East Queensland: 4.3%

## **5.3 per cent is within the range of margins from the expected returns approach**

When we recommended Victorian Default Offer prices in 2019, we engaged Frontier Economics to provide a report on retailers' retail operating margins. This report included two approaches: the regulatory benchmarking approach and the expected returns approach. At the time, Frontier's estimated range for the retail operating margin based on the expected returns approach was 4.8 to 6.1 per cent.<sup>100</sup>

Recently the Independent Competition and Regulatory Commission engaged Frontier Economics to undertake similar work for their draft decision on standing offer prices to apply between 2024–25 and 2026–27.<sup>101</sup> Frontier Economics range for expected returns was 4.5 to 5.9 per cent.

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<sup>98</sup> Our internal analysis shows, retailers' actual operating margins in Victoria was averaged less than 2 per cent over the last two years.

<sup>99</sup> Australian Competition and Consumer Commission, Inquiry into National Electricity Market, December 2023, Page 34

<sup>100</sup> Frontier Economics, Retail costs and margin, a report for the Essential Services Commission, April 2019, p. 29.

<sup>101</sup> Frontier Economics, Retail electricity price investigation 2024-27, November 2023, p.62.

The retail operating margin of 5.3 per cent that we have adopted in our draft decision for the 2024–25 Victorian Default Offer is within the range estimated by Frontier Economics.

### **We considered stakeholders' submissions on the retail margin**

We received 14 submissions on the retail operating margin. We received 9 from retailers and the Australian Energy Council.<sup>102</sup> We received 4 from the consumers and consumer advocates.<sup>103</sup>

In general retailers sought a higher retail margin in the Victorian Default Offer while consumer advocates were of the view that the retail margin should be lower.

*Stakeholders did not propose alternative approaches that demonstrated they better met Victorian Default Offer objectives*

In our request for comment paper, we requested feedback from stakeholders on alternative ways to estimate an efficient retail operating margin.

Most submissions on the margin provided no alternative approaches for us to consider. A few retailers suggested we rerun the expected returns approach with updated data to inform our decision on the margin. One consumer advocate proposed that we carry out a bottom-up assessment to derive a retail margin.<sup>104</sup>

Given Frontier Economics has recently completed an updated expected returns assessment, and there was very little support for using new approaches to assess the retail margin, we have continued to use a regulatory benchmarking approach for this decision.<sup>105</sup>

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<sup>102</sup> AGL Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 1; EnergyAustralia, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p.2, Origin Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, pp.3-4, Consumer Action Law Centre, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2, 1stEnergy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, Brian and Jill Golland, submission to the Essential Services Commission '2024–25 Victorian Default Offer: Request for Comment' December 2023, p.1, Joint submission from Victorian Council of Social Service (VCOSS), Brotherhood of St Laurence, Consumer Action Law Centre, Council Of The Ageing Victoria, Energy Consumers Australia, Financial Counselling Victoria Inc, Good Shepherd Australia New Zealand, submission to the Essential Services Commission '2024–25 Victorian Default Offer: Request for Comment' December 2023, p.3, Alinta Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, Shell Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, GloBird Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>103</sup> Consumer Action Law Centre, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2.

<sup>104</sup> Consumer Action Law Centre, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, p. 2.

<sup>105</sup> Frontier Economics, Retail electricity price investigation 2024-27, November 2023, p.49.

### *Increased cost of debt*

Several retailers supported their view that the margin should increase by highlighting the rising cost of debt since we first considered the retail margin in 2019.<sup>106</sup>

We acknowledge that interest rates have increased. However, interest costs are only one part of the retail margin. While changes in interest rates are relatively easy to observe, other parts of the margin are not. As a result, in assessing whether the margin should change we must also consider other information. Taking into account a range of information from a number of other different sources such as other regulators' margins, retailers' actual margins, retailers' market offers, and results from the expected returns approach, we consider that a margin of 5.3 per cent is appropriate.

### *We use a range of information sources to cross check the regulatory benchmarks*

Some stakeholders noted that the current approach, using regulatory benchmarking, is circular.<sup>107</sup>

As noted above, we have cross checked our retail margin benchmark with other information including data on retailers' actual margins, and Frontier's latest range for the retail margin using expected returns approach.<sup>108</sup>

Some stakeholders requested more clarity around how we decided on a retail margin of 5.3 per cent for 2023–24.<sup>109</sup> The information we had regard to is outlined in our final decision on the 2023–24 Victorian Default Offer.<sup>110</sup>

### *We set the benchmark retail margin at an industry level*

Shell Energy expressed their concern that the current margin relies on other regulators' decisions and does not reflect small tier 2 and tier 3 retailers.<sup>111</sup>

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<sup>106</sup> Alinta Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023. 1stEnergy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>107</sup> Origin, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, energy Australia, Energy Australia, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

<sup>108</sup> Frontier Economics, Retail electricity price investigation 2024-27, November 2023, p.49, Australian Competition and Consumer Commission, Inquiry into National Electricity Market, December 2023, Page 34.

<sup>109</sup> GloBird Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, Simply Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023

<sup>110</sup> Essential Services Commission, Victorian Default Offer 2023-24: Final Decision Paper, May 2023 p. 48

<sup>111</sup> Shell Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

We are not required to set the retail operating margin at a level that reflects individual retailers' costs. We set the margin so that at an industry level it provides a suitable return to incentivise investment in the industry for an efficient retailer.

*Higher competition would not be expected to lead to higher margins*

Some retailers made submissions that using regulatory benchmarking was inappropriate as competition is higher in Victoria than in other Australian jurisdictions.<sup>112</sup>

With more competitors in the market, consumers generally have more options to choose from and retailers face stronger pressure to reduce costs, so they can offer lower prices or offer better value in other ways. Therefore, increased competition would not be expected to lead to higher average profit margins.

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<sup>112</sup> Momentum Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023, AlintaEnergy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023

# Calculating tariffs and the maximum annual bill

After setting our cost benchmarks, we turn the costs into prices for the Victorian Default Offer using three different methods:

- **flat tariffs** – for standing offers with flat tariffs
- **two-period time of use tariffs** – for standing offers with two-period time of use tariffs
- **the compliant maximum bill** – for standing offers with non-flat tariffs, other than two-period time of use tariffs (the compliant maximum annual bill is based on the two-period time of use tariffs).

## 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 tariff, the variable charge is always the same. On the other hand, for time of use tariffs and other non-flat tariffs, the variable charges will change depending on when electricity is used. Under a time of use tariff structure, the variable charge is usually more expensive at times of peak demand.

## Our draft decision on flat tariffs

Our draft decision is to use the same approach to setting standing offer rates for flat tariffs as we have in past reviews.

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

## Flat tariff cost allocation

### Daily supply charge (fixed costs) =

(retail operating costs + acquisition costs + fixed network costs + feed in tariff social cost of carbon + 'other' fixed costs) x (1 + retail operating margin) x (1 + GST rate) ÷ days in the year

### Usage charge (variable costs) =

(wholesale electricity costs + SRES/LRET/VEU costs + 'other' variable costs + electricity network losses + variable network costs) x (1 + retail operating margin) x (1 + GST rate)

## Our draft decision on two-period time of use tariffs

Our draft decision is to use the same approach to setting standing offer rates for two-period time of use tariffs as we have in our past Victorian Default Offer price determinations. Under this approach, we align the two-period time of use tariff structures with the underlying network tariffs for each distribution network.

### 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 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 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 peak and off-peak network rates).

### Cost allocation two-period time of use tariffs

#### Daily supply charge (fixed costs) =

(retail operating costs + acquisition costs + fixed network costs + feed in tariff social cost of carbon + 'other' fixed costs) x (1 + retail operating margin) x (1 + GST rate) ÷ days in the year

#### Peak usage charge (variable costs) =

(wholesale electricity costs + SRES/LRET/VEU costs + 'other' variable costs + electricity network losses + variable network costs for peak period) x (1 + retail operating margin) x (1 + GST rate)

#### Off peak usage charge (variable costs) =

(wholesale electricity costs + SRES/LRET/VEU environmental program costs + 'other' variable costs + electricity network losses + variable network costs for off-peak period) x (1 + retail operating margin) x (1 + GST rate)

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

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. The compliant maximum annual bill amount is calculated based on the two-period time of use tariffs. This is consistent with the approach we have taken since introducing the two-period time of use tariff.



Retailers offering other types of 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 Victorian Default Offer, without removing the option of other non-flat standing offer tariffs.

### Annual reference consumption amount

The annual reference consumption amount used to determine the 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 maximum annual bill amount, we assume customers use the same amount of electricity on each day of the year.

### Representative usage profiles and related usage allocations

We have not updated the usage profiles for calculating the compliant maximum annual bill amounts for the 2024–25 Victorian Default Offer determination. We have examined changes in the share of load but there have not been significant changes since 2020–21.

We used manually read interval meter data provided by the Australian Energy Market Operator to calculate these profiles.

**Table 3: Domestic – usage profile for maximum bill calculation**

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

**Table 4: Small business – usage profile for maximum bill calculation**

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

## Calculating the compliant maximum annual bill amount

The compliant maximum annual bill amount for other non-flat standing offers is calculated using the relevant:

- annual reference consumption amount
- usage profiles as specified in tables 3 and 4
- two-period time of use tariffs determined by the commission for each distribution zone.

## Retailers must show they comply with the maximum annual bill amount

If offering non-standard tariffs (standing offer tariffs that are not the flat or two-period time of use tariffs) a retailer must show those tariffs do not result in a total annual electricity bill that exceeds the relevant compliant maximum annual bill amount determined by the commission. In determining non-standard tariffs, the retailer must use its own representative usage profile, or relevant usage allocations, which reflects a reasonably representative estimate of consumption for the applicable group of customers over a 365-day period.

A retailer's estimated annual electricity bill for a non-standard tariff must be calculated using the relevant annual reference consumption amount for total annual usage as determined by the commission. This total usage amount must then be allocated according to the retailer's representative usage profile and multiplied by the retailer's relevant non-standard tariff rates.

## Appendix A: 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 Victorian Default Offer tariffs and maximum bill.

### Wholesale electricity costs

We engaged Frontier Economics to estimate wholesale electricity costs for 2024–25 using the method described in the chapter on cost components. This methodology produces an estimate based on a 12-month trade weighted average of future contract prices and a volatility allowance for setting aside cash to fund unexpectedly high spot prices.

These costs vary for each distribution zone due to differences in customer load profiles. The estimated wholesale costs for 2024–25 are presented in Table A.1.

**Table A.1: Wholesale electricity forecasts for 2024–25 (\$/MWh, nominal, GST exclusive)**

Distribution zone	Domestic		Small business	
	Wholesale price	Volatility adjustment	Wholesale price	Volatility adjustment
AusNet Services	\$121.13	\$0.29	\$98.00	\$0.25
CitiPower	\$105.35	\$0.24	\$94.73	\$0.27
Jemena	\$118.90	\$0.30	\$100.36	\$0.30
Powercor	\$120.35	\$0.33	\$96.18	\$0.25
United Energy	\$116.51	\$0.29	\$99.62	\$0.29

Source: Frontier Economics, *Wholesale electricity costs for 2024–25: A draft report for the Essential Services Commission*, February 2024.

### 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 program obligations of retailers.

We calculated the loss factors based on the 2023–24 distribution loss factors and the preliminary 2023–24 marginal loss factors published by Australia Energy Market Operator (see table A.2).<sup>113</sup>

**Table A.2: Network losses for 2024–25**

Distribution zone	Distribution loss factor (DLF)	Marginal loss factor (MLF)	Total loss factor
AusNet Services	1.0810	1.0041	8.54%
CitiPower	1.0450	1.0000	4.50%
Jemena	1.0447	1.0006	4.53%
Powercor	1.0738	0.9980	7.17%
United Energy	1.0483	0.9987	4.69%

Source: Australian Energy Market Operator, Distribution Loss Factors 2023–24 and Marginal Loss Factors 2023–24.

## Network costs

Electricity retailers must pay network costs which include distribution, transmission and jurisdictional charges. Electricity distribution network businesses charge these costs to retailers via network tariffs. These tariffs are typically made up of a fixed daily charge, per kilowatt hour usage charges, and an annual metering charge.

Tables A.3 and A.4 show the indicative network tariffs that Victorian network businesses submitted to the Australian Energy Regulator in February 2024. We will update these tariffs with the tariffs approved by Australian Energy Regulator when we make our final decision.

**Table A.3 Domestic electricity network charges, flat tariff, 2024–25 (GST exclusive)**

Distribution zone	Daily charge (\$ per year)	Variable charge structure	Variable charge (\$ per kWh)	Controlled load (\$ per kWh)
AusNet Services	\$141.16	Block 1 Block 2	\$0.1347 \$0.1374	\$0.0479
CitiPower	\$90.01	Anytime	\$0.0803	\$0.0241
Jemena	\$111.59	Anytime	\$0.1019	\$0.0409
Powercor	\$139.98	Anytime	\$0.0947	\$0.0266
United Energy	\$89.97	Anytime	\$0.0897	\$0.0256

<sup>113</sup> Australian Energy Market Operator, Distribution Loss Factors for the 2023-24 Financial Year, July 2023, p. 12; CitiPower, Powercor & United Energy, response to Distribution data: solar export and transmission lines, October 2023; AusNet, response to request on AusNet Services data - solar export and transmission lines, September 2023; Australian Energy Market Operator, Marginal Loss Factor: Financial Year 2023–24, March 2023, pp. 24-25.

Source: 2024-25 pricing proposals of Victorian distribution businesses approved by the Australian Energy Regulator.

**Table A.4 Small business electricity network charges, flat tariff, 2024–25 (GST exclusive)**

Distribution zone	Daily charge (\$ per year)	Variable charge structure	Variable charge (\$ per kWh)
AusNet Services	\$141.16	Block 1 Block 2	\$0.1939 \$0.2038
CitiPower	\$150.02	Anytime	\$0.0888
Jemena	\$170.40	Anytime	\$0.1341
Powercor	\$179.98	Anytime	\$0.1059
United Energy	\$150.02	Anytime	\$0.0986

Source: 2024-25 pricing proposals of Victorian distribution businesses approved by the Australian Energy Regulator.

Tables A.5 and A.6 show the indicative two-period network tariffs that Victorian network businesses submitted to the Australian Energy Regulator. We will update these tariffs with the approved tariffs when we make our final decision.

**Table A.5 Domestic electricity network charges, two-period time of use network tariffs, 2024–25 (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	\$141.16	\$0.2384	\$0.0479	\$0.0479
CitiPower	\$90.01	\$0.1599	\$0.0400	\$0.0241
Jemena	\$111.59	\$0.1685	\$0.0483	\$0.0409
Powercor	\$139.98	\$0.1851	\$0.0463	\$0.0266
United Energy	\$89.97	\$0.1751	\$0.0437	\$0.0256

Source: 2024-25 pricing proposals of Victorian distribution businesses approved by the Australian Energy Regulator.

**Table A.6 Small business electricity network charges, two-period time of use network tariffs 2024–25 (GST exclusive)**

Distribution zone	Daily charge (\$ per year)	Peak variable charge (\$ per kWh)	Off-peak variable charge (\$ per kWh)
AusNet Services	\$141.16	\$0.2042	\$0.0481
CitiPower	\$150.02	\$0.1446	\$0.0322
Jemena	\$303.70	\$0.1704	\$0.0357

Powercor	\$179.98	\$0.1886	\$0.0419
United Energy	\$150.02	\$0.1618	\$0.0360

Source: 2024-25 pricing proposals of Victorian distribution businesses approved by the Australian Energy Regulator.

Table A.7 shows a mass market weighted average of the AER approved network metering charges for 2023–24, adjusted for changes in the consumer price index. We used these charges in the draft decision since indicative metering charges for 2024–25 were not available. We will update these with the AER approved charges when we make our final decision.

**Table A.7 Network metering charges, 2024–25 (GST exclusive)**

Distribution business	Annual metering charge (\$ per customer)
AusNet Services	\$84.38
CitiPower	\$72.14
Jemena	\$62.44
Powercor	\$68.43
United Energy	\$48.87

Source: 2023-24 pricing proposals of Victorian distribution businesses approved by Australian Energy Regulator, Australian Bureau of Statistics (Dec-quarter-2023), [Consumer Price Index, Australia](#), ABS Website, accessed 19 February 2024.

## Environmental scheme costs

### Large-scale Renewable Energy Target costs

Under the Large-scale Renewable Energy Target scheme, the Clean Energy Regulator has set the 2023 renewable power percentage (18.96 per cent). We also use the 12-month average of forward market prices for financial year 2024–25 large-scale generation certificates.<sup>114</sup> With these two pieces of information set a benchmark amount for the \$/MWh retailers must spend to fulfill their Large-scale Renewable Energy obligations.

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<sup>114</sup> Frontier Economics, Wholesale electricity costs for 2024–25: A draft report for the Essential Services Commission, February 2024, pp. 46-47.

## Small-scale Renewable Energy Scheme costs

The federal Clean Energy Regulator has not yet published the binding small-scale technology percentage for 2024 or 2025. We used the mid-point between the 2024 non-binding and 2025 non-binding small-scale technology percentage to calculate the liability for this decision.<sup>115</sup>

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.

Using this liability amount and certificate prices we set our benchmark for the cost of complying with Small-scale Renewable Energy Scheme Requirements.

## Victorian Energy Upgrades program costs

For the cost of complying with the Victorian Energy Upgrades program, we use the relevant greenhouse gas reduction rate for electricity for the calendar year 2024 (0.15244).<sup>116</sup> We estimate the cost of Victorian energy efficiency certificates using the trade-weighted average of 12-months of historic spot market prices. Based on the information available on 17 January 2024, we estimated an average price of \$77.15 per certificate for the draft decision. Our estimate of the per megawatt hour Victorian Energy Upgrades program costs for the draft decision is \$11.76, which is higher than the estimate used in the 2023–24 Victorian Default Offer of \$11.18 due to higher certificate prices.

## Feed-in Tariff (social cost of carbon)

For the draft decision, the impact of the feed-in tariff on retailer costs is based on total small-scale renewable exports in the most recently available financial year multiplied by the social cost of carbon (2.5 cents per kWh for 2024–25).<sup>117</sup> The resulting figure is divided by the total average domestic and small business customer numbers in the same period.

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<sup>115</sup> Clean Energy Regulator, The small-scale technology percentage, accessed 24 January 2024, [The small-scale technology percentage \(cleanenergyregulator.gov.au\)](https://www.cer.gov.au/energy-renewables/small-scale-renewable-energy/scheme-requirements).

<sup>116</sup> Essential Services Commission, Energy retailers in the VEU program: Determining liability, <https://www.esc.vic.gov.au/victorian-energy-upgrades-program/participating-veu-program/energy-retailers-veu-program#toc--determining-liability>, accessed 24 January 2024.

<sup>117</sup> Total solar exports from 1 July 2022 to 30 June 2023.

**Table A.8: Cost of complying with environmental schemes (GST exclusive):**

Environmental scheme	Certificate price, \$/MWh	Scheme liability, %	Cost, \$/MWh
Large-scale Renewable Energy Target	\$48.36	18.96	\$9.17
Small-scale Renewable Energy Scheme	\$40.00	16.39	\$6.56
Victorian Energy Upgrades	\$77.15	15.24	\$11.76
Feed-in Tariff (social cost of carbon)			\$17.70/customer

Source: ESC analysis and Frontier Economics, *Wholesale electricity costs for 2024–25: A draft report for the Essential Services Commission*, February 2024.

## Retail operating costs and margin

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

### Retail costs

Our updated benchmark is \$142.54 excluding GST for retail operating costs.

### Customer acquisition and retention costs

Our benchmark for the draft decision is \$45.05 excluding GST for customer acquisition and retention costs.

### Retail margin

We applied a retail margin of 5.3 per cent of total revenue.

**Table A.9: Retail costs and margin (GST exclusive)**

Retail costs and margin	Annual benchmark
Retail operating costs	\$142.54
Customer acquisition and retention costs	\$45.05
Retail margin	5.3%

## 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 and compensation updates.<sup>118</sup> The estimate of our licence fee is a market-wide average based on the approved fees for the year 2023–24, which is the latest available information. We adopted a forecast of ancillary charges based on analysis of the past 12 months of ancillary service cost data.

**Table A.10: Other costs (GST exclusive)**

Charge	Rate
Essential Services Commission licence fee	\$2.27/customer
Ancillary services	\$0.37/MWh
Market suspension compensation	\$0.0033/MWh
Directions – usage	\$0.00/MWh
Administered price cap – usage	\$0.00/MWh
<b>Australian Energy Market Operator fees</b>	
National Electricity Market fees	\$0.30/MWh
National Electricity Market fees - fixed	\$4.80/customer
Electricity retail market fee (formally Full retail contestability fee)	\$1.52/customer
IT Upgrade and Five-minute and global settlement compliance fees	\$0.10/MWh
IT Upgrade and Five-minute and global settlement compliance fees - fixed	\$1.63/customer
Distributed energy resources integration program fees	\$0.01/MWh
Distributed energy resources integration program fees - fixed	\$0.19/customer
Energy Consumers Australia	\$0.66/customer
Reliability and Emergency Reserve Trader	\$0.00/customer
<b>Total per MWh:</b>	<b>\$0.78/MWh</b>

<sup>118</sup> Australian Energy Market Operator, [Budget and fees: FY24](#), 26 June 2023, accessed 16 January 2024. Australian Energy Market Operator, [June 2022 NEM Events: Compensation Update \(6 June 2023\)](#), accessed 24 January 2024.

**Total per customer:**

**\$11.07/customer<sup>119</sup>**

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<sup>119</sup> Values in the table do not sum to exact total due to rounding.

## Appendix B: Network tariffs in the cost stack

**Table B.1: Single 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	Small business single rate, C1G
Jemena	Residential single rate, A100/F100	Small business single rate, A200/F200
Powercor	Residential single rate, D1	Small business single rate, ND1
United Energy	Residential single rate, LVS1R	Small business single rate, LVM1R

**Table B.2: Two period time of use network tariff categories**

Distribution zone	Domestic tariff	Small business tariff
AusNet Services	Small residential time of use, NAST11	Small business time of use, NAST12
CitiPower	Residential TOU, CRTOU	Small business TOU, CGTOU
Jemena	Residential TOU, A120/F120	Small business TOU weekdays, A210/F210
Powercor	Residential TOU, PRTOU	Small business TOU, NDTOU
United Energy	Residential TOU, URTOU	Small business TOU, LVTOU

**Table B.3: 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

**Table B.4: Metering configurations used to calculate metering costs for each DNSP**

Distributor	Meter Configuration
Ausnet Services	Single phase single element
Ausnet Services	Single phase, two element with contactor
Ausnet Services	Multiphase
Ausnet Services	Multiphase, direct connected with contactor
Ausnet Services	Multiphase current transformer connected meter
CitiPower	Single Phase
CitiPower	Three phase direct connected meter
CitiPower	Three phase current transformer connected meter
Jemena	Single phase single element meter
Jemena	Single phase single element meter with contactor
Jemena	Three phase direct connected meter
Jemena	Three phase current transformer connected meter
Powercor	Single Phase
Powercor	Three phase direct connected meter
Powercor	Three phase current transformer connected meter
United Energy	Single phase single element meter
United Energy	Single phase single element meter with contactor
United Energy	Three phase direct connected meter
United Energy	Three phase current transformer connected meter

## Appendix C: Stakeholder submissions on request for comment paper

Name of organisation	Date received
Anonymous customer	02 November 2023
Brian and Jill Golland	14 December 2023
Samantha van Dorssen	13 November 2023
Consumer Action Law Centre (CALC)	14 December 2023
Energy Consumers Australia	14 December 2023
Australian Energy Council (AEC)	14 December 2023
1 <sup>st</sup> Energy	14 December 2023
AGL Energy	14 December 2023
Alinta Energy	14 December 2023
EnergyAustralia	14 December 2023
GloBird Energy	05 December 2023
Momentum Energy	14 December 2023
Origin Energy	14 December 2023
Shell Energy	14 December 2023
Simply Energy	14 December 2023
Joint submission from Victorian Council of Social Service (VCOSS), Brotherhood of St Laurence, Consumer Action Law Centre, Council Of The Ageing Victoria, Energy Consumers Australia, Financial Counselling Victoria Inc, Good Shepherd Australia New Zealand	21 December 2023

## Appendix D: Changes to cost benchmarks

Table D.1 shows how our cost stack has changed compared to the 2023–24 Victorian Default Offer.

**Table D.1: Comparison of 2023–24 Default Offer and 2024–25 Default Offer draft decision**

Item	2023–24 Victorian Default Offer final decision	2024–25 Victorian Default Offer draft decision
<b>Victorian Default Offer costs</b>		
Wholesale electricity costs	<p>12-month trade weighted contract price is calculated from the daily settlement price for each day in the period except the date that options contracts are exercised.</p> <p>Removed peak swap contracts from our wholesale cost benchmark. This better reflects retailers' actual approach to building their hedgebooks.</p> <p>Final reading last Friday of April.</p>	No change in approach.
Network costs	<p>Australian Energy Regulator's approved network tariffs are treated as pass through costs.</p> <p>Metering costs based on customer weighted average metering costs.</p>	<p>We have used the indicative network tariffs that Victorian network businesses submitted to the Australian Energy Regulator in February 2024.</p> <p>Metering costs based on customer weighted average of current metering costs adjusted for inflation.</p> <p>For the final decision, we will use the network costs approved by the Australian Energy Regulator.</p>
<i>Environmental costs</i>		
Large-scale Renewable Energy Target	Estimated based on the 2023 renewable power percentage (RPP)	No change in approach. 2023 Renewable power

Item	2023–24 Victorian Default Offer final decision	2024–25 Victorian Default Offer draft decision
	<p>multiplied by the futures market price for large-scale generation certificates for 2023–24.</p> <p>True-up included to account for difference between 2022 RPP, used in 2022–23 Victorian Default Offer final decision, and the midpoint between 2022 and 2023 RPP's..</p>	<p>percentage (RPP) multiplied by the futures market price for large-scale generation certificates for 2024–25.</p> <p>No true-up was performed, we will include a true-up in the final decision.</p>
Small-scale Renewable Energy Scheme	<p>Estimated based on mid-point between 2023 binding and 2024 non-binding small-scale technology percentage multiplied by the clearing house price for small-scale technology certificates.</p> <p>True-up included to account for the difference between the 2023 non-binding, used in the 2022–23 Victorian Default Offer final decision, and the 2023 binding percentage.</p>	<p>No change in approach but updated small-scale technology percentage to reflect midpoint between the 2024 non-binding and 2025 non-binding percentages.</p> <p>No true-up was performed, we will include a true-up in the final decision.</p>
Victorian Energy Upgrades	<p>Estimated based on the 2023 greenhouse reduction rate for electricity multiplied by the historic 12-month trade-weighted average price for Victorian energy efficiency certificates.</p>	<p>No change in approach but used 2024 greenhouse reduction rate and used more recent 12-month Victorian energy efficiency certificates prices and trade volumes.</p>
Minimum feed-in tariff (social costs of carbon)	<p>Estimated based on total renewable exports for the 2022 calendar year, multiplied by the social cost of carbon then divided by total average number of domestic and small business customers for the same period.</p>	<p>No change in approach but used renewable export data and total average customer numbers for financial year 2022–23.</p>
Retail operating costs	<p>Estimated based on a benchmark set by taking the customer weighted average of retailers' actual operating cost data from financial year 2021–22. This benchmark was adjusted for the change in consumer price index since June 2022.</p>	<p>No change in approach. Updated information to reflect retailers' 2022–23 actual operating cost data and adjusted for the change in consumer price index since June 2023.</p>

Item	2023–24 Victorian Default Offer final decision	2024–25 Victorian Default Offer draft decision
Customer acquisition and retention costs	Estimated based on cost levels from the Australian Competition and Consumer Commission’s retail and electricity pricing inquiry’s final report updated for inflation. <sup>120</sup>	No change in approach. Updated for inflation.
Other costs	<p>Estimated and updated based on the latest available information on the: Australian Energy Market Operator’s compensation updates, fees and charges for general NEM operations, Distributed Energy Resources Integration Program, IT and five-minute settlement and Energy Consumers Australia; ancillary fees; reliability and emergency reserve trader costs; and Essential Services Commission licence fees.</p> <p>Included amounts to reflect known market intervention compensations amounts determined by the Australia Energy Market Operator for directions, suspension pricing (provisional and revision amounts) and administered pricing compensations claims as of 28 April 2023 relating to the June 2022 market intervention event.</p>	No change in approach but used more recent Australian Energy Market Operators final budget and fees and included known costs recovered due to market intervention events.
Retail operating margin	<p>Set at 5.3% of cost stack having regard to benchmarks set by other regulators and the expected returns model.</p> <p>This better reflects current market conditions.</p>	No change in approach.
<b>Other matters</b>		
Tariffs and structure	<p>Flat tariffs</p> <p>Two period time-of use tariffs</p>	No change in approach.

<sup>120</sup> Australian Competition and Consumer Commission, Retail electricity pricing inquiry – Final report, July 2018.



Item	2023–24 Victorian Default Offer final decision	2024–25 Victorian Default Offer draft decision
	Compliant maximum annual bill based on two period time-of use tariffs	
Regulatory period	12 months	No change in approach.
Consultation papers	Replaced with one request for comment paper at the beginning of each review.	No change in approach.

**Table D.2: Changes in average domestic costs benchmarks, \$ nominal (average across all five Victorian distribution zones).**

Item	2023–24 Victorian Default Offer final decision	2024–25 Victorian Default Offer draft decision
Wholesale electricity costs	\$636	\$495
Network costs	\$549	\$583
Environmental costs	\$132	\$134
Retail operating costs (including acquisition costs)	\$176	\$188
GST	\$160	\$149
Retail operating margin	\$85	\$79
Other costs	\$18	\$14
<b>Total</b>	<b>\$1,755</b>	<b>\$1,643</b>

# Appendix E: Order in Council



## Victoria Government Gazette

No. S 208 Thursday 30 May 2019  
By Authority of Victorian Government Printer

### Electricity Industry Act 2000 ORDER UNDER SECTION 13 OF THE ELECTRICITY INDUSTRY ACT 2000

#### Order in Council

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;

**SPECIAL**

- (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*'):
  - one flat tariff that is available to each domestic customer;
  - one flat tariff with a controlled load tariff that is available to each domestic customer with a controlled load; and
  - one flat tariff that is available to each small business customer,
 which tariffs must be:
  - for the period from 1 July 2019 to 31 December 2019, those fixed in accordance with clause 6(2) and clause 6(3);
  - 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:
  - are not flat tariffs; or
  - 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;
    - (d) retail operating costs, including modest costs of customer acquisition and

- retention;
  - (e) retail operating margin; and
  - (f) 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
  - (b) 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
    - (d) Any actual comparison in accordance with the methodology must be readily understandable by a prescribed customer.

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4. 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<sub>p</sub>* is the retailer's peak usage charge;

*UA<sub>p</sub>* is the peak usage allocation specified in column 2 of Table 1;

*UC<sub>s</sub>* is the retailer's shoulder usage charge;

*UA<sub>s</sub>* is the shoulder usage allocation specified in column 3 of Table 1;

*UC<sub>OP</sub>* is the retailer's off-peak usage charge; and

*UA<sub>OP</sub>* 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<sub>GU</sub>* 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<sub>CL</sub>* is the usage charge for controlled load usage; and

*ARC<sub>CL</sub>* 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



# Victoria Government Gazette

No. S 216 Tuesday 4 June 2019  
By Authority of Victorian Government Printer

**Electricity Industry Act 2000**  
**ORDER UNDER SECTION 13 OF THE**  
**ELECTRICITY INDUSTRY ACT 2000**

Order in Council

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 purpose of this Order is to make amendments to the Victorian default offer tariffs applying under the Order in Council made under section 13 of the Electricity Industry Act 2000 and published in the Government Gazette No. S 208 on 30 May 2019 (*VDO Order*).

**2. Commencement**

This Order comes into effect on the date on which it is published in the Government Gazette.

**3. Amendments**

In column 5 ('Usage charge: controlled load') of the table in Schedule 1 to the VDO Order:

- (a) for '\$0.1618' substitute '\$0.1917'; and
- (b) for '\$0.1561' substitute '\$0.1831'.

Dated 4 June 2019

Responsible Minister

HON. LILY D'AMBROSIO MP

Minister for Energy, Environment and Climate Change

PIETA TAVROU  
Clerk of the Executive Council

**SPECIAL**

**ORDERS IN COUNCIL**

Electricity Industry Act 2000

**VICTORIAN DEFAULT OFFER ORDER IN COUNCIL**

Order in Council

The Lieutenant-Governor, as the Governor's deputy, with the advice of the Executive Council under section 13 of the Electricity Industry Act 2000 makes the following Order:

**1. Purpose**

The purposes of this Order are to amend the VDO Order in Council to:

- (a) specify that the VDO Order in Council does not apply to the sale of electricity to an unmetered supply site; and
- (b) require a review of the VDO Order in Council to commence before 31 May 2026 and every three years thereafter.

**2. Definitions**

In this Order:

*VDO Order in Council* means the Order in Council made on Thursday 30 May 2019 under section 13 of the Electricity Industry Act 2000 and published in Special Gazette No. S 208.

**3. Commencement**

This Order comes into effect on the day it is published in the Government Gazette.

**4. Amendments**

- (1) In clause 4(1) of the VDO Order in Council, insert the following definitions –

*government agency* includes:

- (a) a Commonwealth, State or local government department; and
- (b) a statutory authority or government owned corporation established under a law of the Commonwealth or a State or Territory;

*unmetered supply* means a supply of electricity to a particular piece of electrical equipment that draws a current and is connected to the distribution network without a meter; and

*unmetered supply site* means a site that consumes by way of unmetered supply, including a government agency, but excluding a site where electricity is supplied to and purchased by domestic or small business customers.'

- (2) After clause 5 of the VDO Order in Council, insert –

**5A. Unmetered supply sites are not covered by this Order**

Despite clause 5, this Order does not apply to the sale of electricity to an unmetered supply site.'

- (3) For clause 17 of the VDO Order in Council, substitute –

**17. Periodic reviews of the operation of this Order**

The Minister must cause a review of the operation and effectiveness of this Order to be undertaken before 31 May 2026 and every three years thereafter.'

Dated: 12 December 2023

Responsible Minister:

HON. LILY D'AMBROSIO MP  
Minister for Energy and Resources

SAMUAL WALLACE  
Clerk of the Executive Council



## Appendix F: Our legislative considerations

The pricing order provides the commission's power to make a Victorian Default Offer price determination and imposes some constraints on that power. This appendix explains the requirements for, and matters we must have regard to in, making the determination.

### **The commission's power to determine the Victorian Default Offer**

The Victorian Default Offer price determination is a determination for purposes of section 33 of the Essential Services Commission Act 2001 (ESC Act). In making a Victorian Default Offer price determination we must adopt an approach and methodology in accordance with section 33(2) of the ESC Act, and the pricing order.<sup>121</sup> Taken together, this means we must adopt an approach and methodology we consider will best meet the objectives specified in the ESC Act, the commission's objectives under the Electricity Industry Act 2000 (EI Act) and the objective of the Victorian Default Offer.<sup>122</sup>

The pricing order gives the commission discretion to decide the approach and methodology to be used for making this Victorian Default Offer price determination.<sup>123</sup> This is however subject to the requirement that the Victorian Default Offer price determination must be based on the efficient costs of the sale of electricity by a retailer,<sup>124</sup> having regard to:<sup>125</sup>

- wholesale electricity costs
- network costs
- environmental costs
- retail operating costs, including only modest costs of customer acquisition and retention<sup>126</sup>

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<sup>121</sup> Clause 12(1) of the pricing order.

<sup>122</sup> Best meeting the objective of the Victorian Default Offer is a requirement of clause 12(2) of the pricing order.

<sup>123</sup> Clause 10(3) of the pricing order read with section 33(5) of the Essential Services Commission Act 2001.

<sup>124</sup> Clause 12(3) of the pricing 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.

<sup>125</sup> Clause 12(4) of the pricing order.

<sup>126</sup> Clause 12(6) of the pricing order specifies that this is to be an amount determined by the commission in its discretion.

- retail operating margin<sup>127</sup>
- any other costs, matters or things we consider appropriate or relevant.

The pricing order also specifies that we must not include headroom.<sup>128</sup>

## **Our objectives in setting the Victorian Default Offer**

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.<sup>129</sup>

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).<sup>130</sup>

The objective of the Victorian Default Offer under the pricing order is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.<sup>131</sup>

As mentioned, when making a Victorian Default Offer price determination, the approach and methodology adopted by the commission must be one that best meets all of these objectives.

## **Other matters the commission must have regard to when determining tariffs**

Section 8A of the ESC Act provides that in seeking to achieve the commission's objective under the ESC Act 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

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<sup>127</sup> 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.

<sup>128</sup> 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.'

<sup>129</sup> Essential Services Commission Act 2001, s 8.

<sup>130</sup> Electricity Industry Act 2000, s 10.

<sup>131</sup> Clause 3 of the pricing order sets out the objective of the Victorian Default Offer.

- 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
- consistency in regulation between States and on a national basis
- any matters specified in the empowering instrument (that is, the pricing order)

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

- the particular circumstances of the regulated industry (that is, retail electricity market) and the prescribed goods and services (that is, 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.<sup>132</sup>

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<sup>132</sup> Under clause 12(11) of the pricing order, section 33(4)(a) does not apply to a Victorian Default Offer determination.