Victorian Default Offer 2023-24

Submission received via Engage Victoria on our draft decision on Victorian Default Offer 2023-24

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What are your views about our proposed approach to setting the 2023–24 Victorian Default Offer?

Energy Locals supports the approach of keeping the methodology consistent with prior year.

We also agree with the proposed approach of including the market intervention costs and other known costs.

The change in methodology of retail operating costs has led to a 4.8% decrease in the allowance for retail costs. This is not reflective of actual costs in a high-inflation environment.

Overall, we agree with using a trade-weighted average price of contracts from all days over the past twelve months to set the wholesale costs, excluding the days when options are exercised. However, we would like the ESC to consider including a premium to reflect the higher cost of over-the-counter (OTC) products.

What are your views about our proposed approach to retail operating costs?

The retail operating costs include the following cost categories:

- billing and revenue collection systems
- information technology systems
- call centre costs
- corporate overheads
- energy trading costs

- provision for bad and doubtful debts
- regulatory compliance costs.

The revised approach to using a benchmark on retailers' actual costs instead of the benchmark set by the Independent Competition and Regulatory Commission has reduced the retail allowance by 4.8% to $178. We understand that the ESC has estimated retailers' actual costs based on data gathered from retailers for the 2021-22 financial year and adjusted for inflation. Arguably, by taking a weighted average approach to determining retailers' actual costs, the VDO is likely to be suitable for larger, tier 1 retailers who have the ability to operate at scale, however, does not reflect the actual costs of smaller retailers, who have already been significantly affected by the events of 2022.

We would like to emphasise that the operating cost allowance should appreciate that some of the costs are directly linked to a retailer's turnover. Based on the increased VDO, revenue per customer will increase by approximately 30%, which will cause an increase of the same magnitude to cost items such as bad debts and working capital. Given that the $250 Power Saving Bonus is not linked to meeting the cost of electricity, it is expected to have no discernible impact on actual bad debts.

In addition, salaries and wages are a major part of a retailer's operating costs, and current inflation levels and interest rates have a direct impact on these costs.

What are your views about our proposed approach to market intervention costs?

We agree with including the known market intervention costs in the 2023-24 Victorian Default Offer. These costs were incurred by retailers and cannot simply be absorbed.

Given that the costs will be recovered with a significant time lag, we suggest including an allowance to cover the cost of capital for the duration the costs are funded by retailers.

In addition, we recommend including an allowance for any costs which have not been finalised by the time the final VDO is issued. This would more closely align the cash outlay and recovery. Any discrepancies can be adjusted in the VDO for the following year.

What are your views about our proposed change of inputs for our wholesale cost forecasts?

Energy Locals agrees with the approach of using the trade-weighted average price of contracts from all days over the past twelve months, except for the days that options are exercised as these would distort the outcome due to the high value of trades on those days.

However, consideration should be given to an additional allowance to the ASX trade-weighted cost to account for premiums included in over-the-counter contracts, as outlined in the ACCC November report.

We would like to point out that many retailers will not have finalised their hedges for the coming period and emphasise that it will be important for the final VDO to reflect the period between the draft and final VDO releases.

Energy Locals disagrees with the ESC's comment that the increase in costs related to credit support requirements is relatively small. In our case, external credit support requirements have gone up significantly following the market disruptions during the middle of the year, which had a corresponding impact on our funding costs.

In addition, the expected increase in electricity costs of 30% will lead to a corresponding increase in working capital requirements, which will also increase funding requirements. We do not believe that this is accurately reflected in the increase in the retail margin.

What are your views about our proposal to start our reviews with 'request for comment' papers?

We believe that the VDO methodology is now well established and we are happy with a 'request for comment' at the start of each review.

Are there any other matters the commission should look into?

We would like to draw attention to the reduced liquidity available to retailers following the withdrawal of clearers from the market. It is now more difficult and expensive for small retailers to access the ASX futures market. This is driving retailers to the OTC market where hedges are traded at a margin to the ASX.

Energy Locals is of the opinion that the draft VDO determination does not fully reflect the cost of market participant funding obligations in its methodology. Retailers are forced to maintain sizeable cash buffers to cater for AEMO margin calls and prudential requirements, which have increased significantly over the past 12 months. In addition, the interest rate increases, and higher perceived risk related to the sector is increasing capital costs for retailers.