

2025-26 Victorian Default Offer: Request for Comment

Introduction

The Victorian Government introduced the Victorian Default Offer in a Governor in Council Order made under section 13 of the *Electricity Industry Act 2000* (pricing order).¹ The Victorian Default Offer regulates standing offer prices for electricity in Victoria supplied and sold to domestic customers or small business customers.^{2 3}

The Essential Services Commission must make a new determination for the Victorian Default Offer to apply from 1 July 2025 to 30 June 2026 on or before 24 May 2025.⁴ We refer to these new pricing arrangements for standing offers as the 2025–26 Victorian Default Offer.

This Request for Comment paper is intended to streamline the early stages of our Victorian Default Offer consultation processes and provide an early indication on the 2025-26 Victorian Default Offer review timelines.

¹ The Order in Council 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'.

² The first Victorian Default Offer was set by the Victorian Government in 2019 based on advice prepared by the Essential Services Commission. 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. Essential Services Commission 2019, Victorian Default Offer to apply from 1 January 2020: final decision

³ Essential Services commission, Victorian Default Offer to apply from 1 January 2020: final decision

⁴ Clause 10(1) of the pricing order.

Table 1: 2025–26 Victorian Default Offer review timeframes

Key milestones	Indicative date
Request for comment paper	28 November 2024
Submissions on request for comment paper close	24 December 2024
Draft decision paper released	March 2025
Public forum on the draft decision paper	March/April 2025
Final decision and determination	Made by 24 May 2025

The Victorian Default Offer regulates standing offer prices

When determining standing offer prices, the commission must adopt an approach and methodology and must determine prices that best meets our objectives under the Essential Services Commission Act 2001⁵ and the Electricity Industry Act 2000^{6,7} as well as the objectives of the Victorian Default Offer specified in the pricing order.⁸ In addition, the tariffs we determine must be based on the efficient cost of the sale of electricity by a retailer.⁹

Our final decision on the 2024–25 Victorian Default Offer includes detailed methodologies we used to calculate each cost component.¹⁰ Past decision papers can be found on our website which includes detailed discussion on our approach to each cost component during each review since 2019.¹¹

The cost components we have regard to for determining 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 operating costs – based on historical cost data
- other costs – taken directly from published reports from industry bodies

⁵ To promote the long-term interests of Victorian consumers having regard to the price, quality and reliability of retail electricity services. See the Essential Services Commission Act 2001, s8.

⁶ To facilitate the development of full retail competition, and to promote protections for customers including in relation to assisting customers who face payment difficulties. See the Electricity Industry Act 2000, s10.

⁷ Essential Services Commission Act 2001, s 33(2).

⁸ To provide a simple trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market. See clause 12.2 and clause 3 of the pricing order.

⁹ Clause 12.3 of the pricing order.

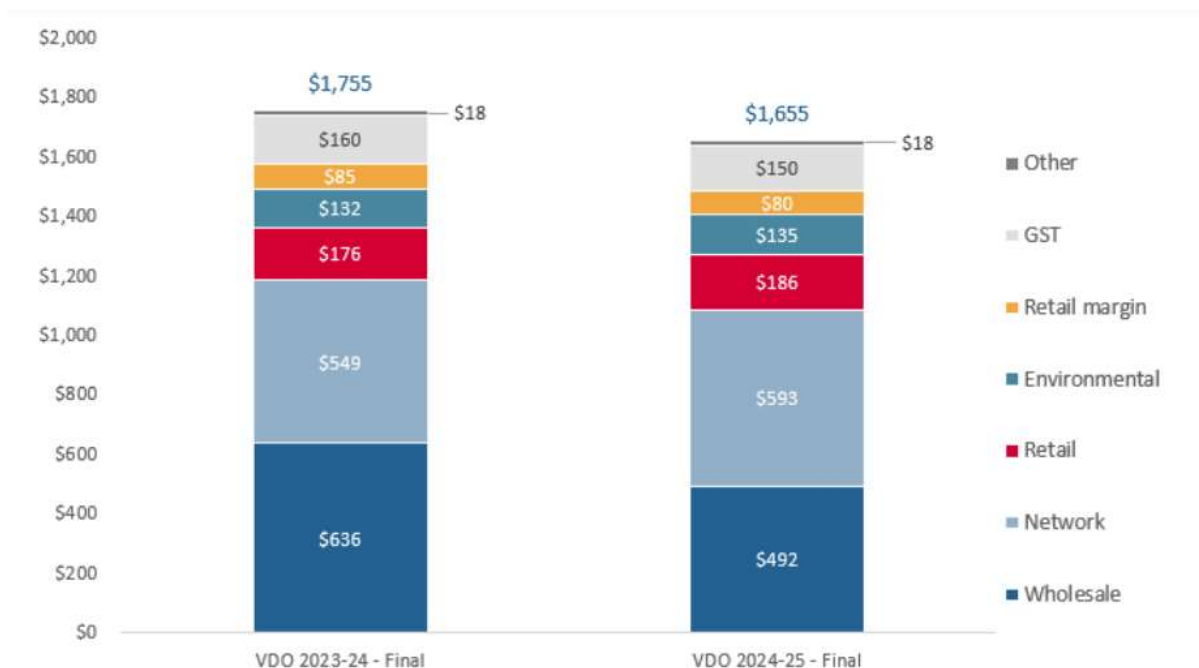
¹⁰ Essential Services Commission, Victorian Default Offer 2023–24: Final Decision Paper, pp. 11-55, 25 May 2023.

¹¹ For more information see the [Essential Services Commission website](#)

- network losses – taken from the Australian Energy Market Operator and electricity distributors
- retail operating margin – based on benchmarking with comparable regulatory decisions.

Our final decision on the 2024–25 Victorian Default Offer represented a \$100 decrease, or 6 per cent reduction, in average domestic annual bills for Victorian Default Offer customers compared to 2023-24. The lower Victorian Default Offer reflected a decrease in future contract prices for wholesale electricity which was offset by increases in network costs. Network costs are approved by the Australia Energy Regulator each year. Figure 1 shows how each cost component makes up the total average annual bill for a domestic Victorian Default Offer customer.

Figure 1: Cost components in annual bills for domestic customers (assuming annual usage of 4,000 kWh) between 2023-24 and 2024-25 Victorian Default Offers



This paper asks for submissions on select matters listed in Box 1.1 and discussed in the following sections. We consider our overall methodology used when determining the Victorian Default Offer is sound, and the purpose of this paper is to seek stakeholders' views on areas of further refinement.

Box 1.1 Matters for interested parties

1. Do you support the Victorian Default Offer estimating retail operating costs separately for domestic and small-business customers?
2. What are your views on the appropriateness of the current retail operating margin and where should it sit within the feasible range?

3. Are there any other considerations we should have in determining a retail operating margin for an efficient electricity retailer?
4. Is there a better approach to estimating Victorian Energy Efficiency Certificate prices?
5. Does the removal of solar exports from the load profile better reflect an efficient retailer's load profile assumptions?
6. Do electricity retailers exclude solar exports from their load profile when buying future wholesale electricity contracts?

All submissions will be considered and may be adopted into the commissions approach where it is considered its inclusion will best meet the objectives of the Victorian Default Offer legislative framework. Noting the short review period, where appropriate, some suggestions may need to be considered over the course of more than one review.

Stakeholders can also make submissions on our draft decision paper, and we will have regard to these submissions when we make our final decision and determination.

How to provide submissions

We invite stakeholders to make submissions in response to this paper by **5pm 24 December 2024**.

We 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

If the deadline for making submissions, or method for making a submission, presents an issue, please email us at VDO@esc.vic.gov.au to discuss other options.

Sensitive or confidential information

We encourage transparency in our review processes. It is our policy to publish all submissions on our website unless the submitter has requested part of, or the entire submission is to be confidential. When we publish a submission, we will also include some details about the submitter (your name, not your address) unless the submitter has requested anonymity (does not want to be identified).

Background

The Victorian Default Offer provides a safeguard for customers

The Victorian Default Offer is based on the efficient costs for the sale of electricity. This provides an important safeguard for consumers who may be on a standing offer contract and are unable or

unwilling to engage in the electricity market. Standing offers are contracts that electricity retailers must make available to domestic and small business customers.¹²

The Victorian Default Offer specifies the prices electricity retailers may charge for standing offers. Around 334,000 households and 57,000 small businesses are on standing offers.¹³ This is around 13 per cent of households and 20 per cent of small businesses.

Since September 2020, the Victorian Default Offer has also applied as a maximum price for most embedded network customers (covering around 180,000 customers).¹⁴ Electricity providers in embedded networks may set prices below the Victorian Default Offer.

The Victorian Default Offer also acts as a comparison price

Most customers are on market contracts, not standing offers. Market offers often have prices below the Victorian Default Offer.

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

We propose to use generally the same methodologies as in past reviews

Our final decision on the 2024–25 Victorian Default Offer includes an overview of the methodologies we used.¹⁵ We are seeking stakeholders' views on the topics raised in this paper. We will consider submissions, along with any supporting evidence provided, and how any change will better meet the objectives and requirements of the Victorian Default Offer framework.

Submissions are welcomed on how we approach each cost component of the Victorian Default Offer; however, we have listed specific topics that we are seeking comment on which are set out in the blue boxes at the end of each section.

¹² 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.

¹³ Figures reflect contract type recorded through National Meter Identifier, as of June 2024. Essential Services Commission, Energy Market Dashboard, available at: <https://www.esc.vic.gov.au/electricity-and-gas/market-performance-and-reporting/victorian-energy-market-report/energy-market-dashboard> .

¹⁴ Figure as of May 2024. Embedded networks supply electricity for many domestic and small business customers in apartment buildings, caravan parks or office blocks.

¹⁵ Essential Services Commission, Victorian Default Offer 2023–24: Final Decision Paper, pp. 11-55, 25 May 2023.

Retail operating cost – separation of domestic and small-business costs

To estimate efficient retail operating costs for electricity retailers, we use a benchmark based on a customer-weighted average of retailers' actual operating costs, adjusted for inflation. This approach, first adopted in the 2023-24 Victorian Default Offer decision, replaced our previous method, which was based on Independent Competition and Regulatory Commission (ICRC) benchmark adjusted for inflation and Victoria-specific operating costs.

This approach applies the retail operating costs, as reported, evenly to domestic and small business customers. Figures 2 and 3 show how much retail operating costs represent as a per cent of a domestic and small business Victorian Default Offer customers bill.

Figure 2: Retail operating costs as proportion of annual bill (residential)¹⁶

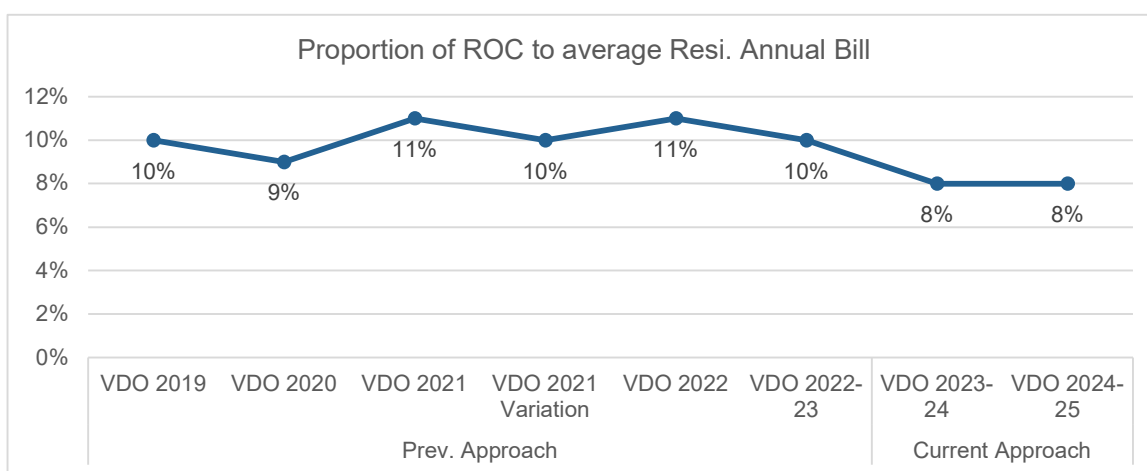
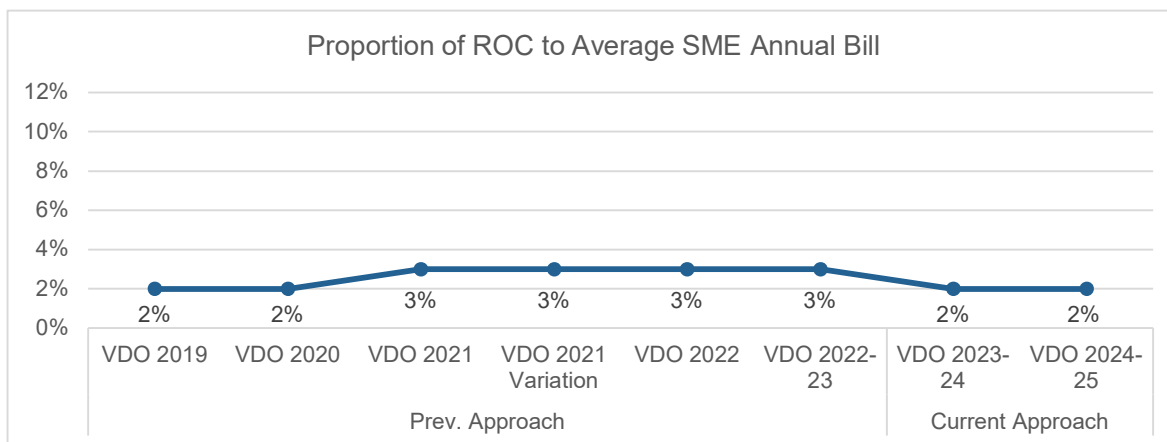


Figure 3: Retail operating costs as proportion of annual bill (small-business)¹⁷



¹⁶ Residential bills assume annual usage of 4,000 kilowatt hours a year and average across five distribution zones.

¹⁷ Small business bills assume annual usage of 10,000 kilowatt hours a year and average across five distribution zones.

Evaluating cost differences by customer types

We are considering whether an efficient electricity retailer would incur different retail operating costs when servicing a domestic or small-business customer. This assessment could lead to separate estimates of retail operating costs for domestic and small business customers in the 2025-26 Victorian Default Offer.

We acknowledge considering retail operating cost separately for domestic and small business customers would be consistent with Australian Energy Regulators approach in the DMO. However, their approach estimates retail costs separately and then adds a separate cost for bad and doubtful debts (approximately \$30 for domestic customers and up to \$60 for small business customers)¹⁸, whereas our approach includes bad debts.¹⁹

Refining our approach with data collection

Starting with the 2023-24 Victorian Default Offer we have gathered actual retail operating costs from electricity retailers to determine a more recent benchmark. In each decision cycle, we have consulted on this change and consider a customer weighted average based on retailers actual operating costs as a robust estimate of efficient retail operating costs. We will continue collecting retailers cost data and continue to apply this approach for the 2025-26 Victorian Default Offer.²⁰

Types of retail operating expenses

Electricity retailers incur various operating costs including:

- cost to serve, which include;
 - billing and revenue collection systems
 - information technology systems
 - call centre costs
- bad and doubtful debts
- regulatory compliance costs.

To better understand any cost variations between customer types, we are collecting data from electricity retailers which requires retail costs be reported separately for domestic and small-

¹⁸ Australian Energy Regulator 2024, Default market offer prices 2024-25: final determination, p. 52, 23 May 2024

¹⁹ It should be noted that DMO, also including additional cost items such as smart meter costs and capital allowance related to smart meters. However, these items are not relevant to Victorian Default Offer.

²⁰ We collect cost data through statutory information gathering notices issued under section 36 of the Essential Services Commission Act, from a sample of retailers. The sample reflects electricity retailers with over 10,000 customers making up close to 98 per cent of market share in Victoria.

business customers. We will consider the submissions we receive in response to this Request for Comment paper when making our draft and final decisions on the 2025-26 Victorian Default Offer.

1. Do you support the Victorian Default Offer estimating retail operating costs separately for domestic and small-business customers?

Retail operating margin

The retail operating margin in the Victorian Default Offer is expressed as a percentage of the cost stack and represents the operating margin required to compensate investors for the capital they provide electricity retailers.²¹ It includes:

- systemic risk (non-diversifiable)
- tax
- depreciation and amortisation.

The pricing order notes that risks accounted for in other components of the cost stack (such as wholesale electricity market price risk) must not be included (to avoid double counting).²² We are not required to base our estimate of the retail operating margin on retailers actual operating margins.²³ In addition, our price determinations must not include headroom.²⁴

The retail operating margin represented 5.3 per cent or \$80 in the average domestic Victorian Default Offer customers for 2024-25.

Historical context and adjustments

In 2019, we recommended a retail operating margin of 5.7 per cent based on a regulatory benchmark. This recommendation was supported by Frontier Economics, which employed two approaches:

- regulatory benchmark approach
- expected returns approach (4.8 to 6.1 per cent).²⁵

For the 2023-24 and 2024-25 Victorian Default Offer decisions, we reduced the retail operating margin to 5.3 per cent, from 5.7 per cent. This adjustment reflects:

²¹ The term 'margin' is used as an estimate of profit divided by sales. Holding the percentage of earnings before interest, taxes, depreciation and amortisation margin constant means that if energy, network and operating costs rise over time the dollar margin will also rise, reflecting an increase in the required capital in dollar terms.

²² Clause 12(7) of the pricing order

²³ Clause 12(9) of the pricing order.

²⁴ Clause 10 of the pricing order.

²⁵ Frontier Economics, Retail costs and margin, a report for the Essential Services Commission, April 2019, p. 29

- decreasing actual margins
- improvement in market competition
- retail market offers below the Victorian Default Offer.²⁶

Latest developments

In 2024 Independent Competition and Regulatory Commission (ICRC) used an expected returns and regulatory benchmark to set a retail margin for 2024-27 at 5.2 per cent (a midpoint of 4.5 per cent and 5.9 per cent of the cost stack).²⁷

The range of the ICRC's 2024 final report closely aligns with the expected returns approach from 2019. In our 2023-24 Victorian Default Offer final decision we observed retailers average retail operating margins have been decreasing since we recommended prices in 2019. This supported our approach to lower the margin to 5.3 per cent. We are seeking views on the where our margin should sit within this range, noting our current retail operating margin is an approximate midpoint.

2. What are your views on the appropriateness of the current retail operating margin and where should it sit within a feasible range?
3. Are there any other considerations we should have in determining a retail operating margin for an efficient electricity retailer?

Environmental costs – estimating Victorian Energy Efficiency Certificate prices

Since 2019, our method for estimating costs for retailers to comply with the Victorian Energy Upgrades program has remained consistent. We base our estimates on the latest 12-month trade-weighted average spot price of Victorian Energy Efficiency Certificates (VEECs), multiplied by the electricity greenhouse gas reduction rate.

Using this approach the cost to comply with this program was \$53.04 a year, as estimated in the 2024-25 Victorian Default Offer for a typical domestic Victorian Default Offer customer. This environmental cost component represents 3 per cent of the average domestic Victorian Default Offer bill.

Feedback on the 2024-25 decision

In response to the 2024-25 Victorian Default Offer draft decision, retailers and retailer groups expressed concern that our approach did not reflect their actual costs. They noted that a lag in spot prices might not capture recent increases in VEEC prices and some retailers suggested shortening

²⁶ Essential Services Commission 2023, Victorian Default Offer 2023-24: Final Decision Paper, 25 May, pp. 47-55

²⁷ Independent Competition and Regulatory Commission 2024, Retail electricity price investigation 2024-27: Final Report, 23 May, p. 45

the averaging period. On the other hand, some stakeholders raised that longer term contracts may be obtained at lower prices.

We considered our approach in sourcing VEEC prices from an open certificate market was transparent, consistent and replicable. We do not consider a shorter average period would reflect efficient costs, and that current high VEEC prices would be reflected in the upcoming 2025-26 Victorian Default Offer review.

Data collection and approach

In our 2024-25 Victorian Default Offer final decision we acknowledged electricity retailers may be meeting their obligations under the Victorian Energy Upgrades program by purchasing a mix of VEECs from the market or via contracts. A mixture of spot market and future contract certificates could result in a lower environmental cost to the retailer and therefore a potential saving for their customers.

To better understand retailer costs in meeting these program obligations, we are collecting additional data for a cross check with our estimate. This will enable us to benchmark our estimate with the actual cost retailers are facing. We are also seeking views on approaches to estimating VEEC prices that better meets our objectives for determining Victorian Default Offer prices and remains transparent and replicable.

4. Is there a better approach to estimating Victorian Energy Efficiency Certificate prices?

Wholesale electricity costs – treatment of solar exports in load profile

To forecast wholesale electricity costs, we estimate customer load profiles by using the most recent three years of customer metered usage data provided by the Australian Energy Market Operator. Our approach has always been to use interval meter data at a net position (the balance of customers consumption and exports). We receive this usage data as recorded at the end of each thirty-minute interval.

Following our final decision on the 2024-25 Victorian Default Offer, we have obtained customers usage split by consumption (customer demand for electricity) and exports (from sources like rooftop solar). This data will enable better visibility of the impact of excluding exports on our wholesale electricity cost forecasts. We will analyse the appropriateness and robustness of this new data set. We are considering whether to continue with our current approach (basing our estimate on a net position) or to exclude solar exports when estimating a customer's future load profile.

We note the Australian Energy Regulator (AER), in setting the Default Market Offer for 2024-25 (DMO6), has excluded customers exports from their load profile. The AER applied a blended

profile that included net system load profile and for the first time, interval meter data.²⁸ Within the interval meter data, the AER excluded all exports and only uses recorded consumption to estimate future customers usage patterns. The AER's DMO7 issues paper indicated its plans to continue excluding solar exports from their load profile assumptions.

5. Does the removal of solar exports from the load profile better reflect an efficient retailer's load profile assumptions?
6. Do electricity retailers exclude solar exports from their load profile when buying future wholesale electricity contracts?

²⁸ Australian Energy Regulator, Default market offer prices: Final determination, pp. 18-40, 23 May 2024.