Next steps for the Victorian Default Offer

Consultation on our approach to network tariff reforms and determination process

14 May 2021

An appropriate citation for this paper is:

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

Contents

We are reviewing the VDO

This paper sets out the Essential Services Commission's (commission's) views on next steps for the Victorian Default Offer (VDO). We are seeking feedback on our intention to vary the current VDO price determination (covering the period from 1 January 2021 to 31 December 2021) for changes to network tariffs applying from 1 July 2021. We are also seeking feedback on our proposed approach to making the next VDO price determination to apply from 1 January 2022.

About the VDO

The VDO was introduced by the Victorian Government to regulate standing offer prices for electricity in Victoria. The VDO started on 1 July 2019.[1]

Standing offers are contracts that electricity retailers are obliged to make available to domestic and small business customers.[2] A standing offer will apply if the customer has:

- never signed up for an electricity contract
- entered into an electricity contract, cancelled the contract within the cooling-off period, but continues to use electricity without entering into a further contract
- moved into a new address and uses electricity without entering into a contract or
- specifically asked for a standing offer.[3]

The two key categories of standing offers to which the VDO applies are:

1. Standing offers with tariffs that do not vary by time or usage (flat tariffs). We specify flat standing offer tariffs for each distribution zone and for domestic (including a controlled load option) and small business customers.
2. Standing offers with tariffs that do vary by time or usage (non-flat tariffs). We determine the compliant maximum annual electricity bill for standing offer customers on non-flat tariffs.

[1] The Victorian Government set the first VDO applying from 1 July 2019 to 31 December 2019 based on advice prepared by the Essential Services Commission. Since then, the commission has regulated VDO prices.

[2] Domestic and small business customers are customers who purchase power for personal, household or domestic use or consume no more than 40 megawatt hours in a year for business use.

[3] Sections 35, 37 and 39 of the *Electricity Industry Act 2000*.

The VDO also operates as a maximum price for most customers in embedded networks.[4]

The objective of the VDO is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity market.[5]

While the VDO is generally available to domestic and small business customers, only around five per cent of households and 15 per cent of small business customers are on standing offers.

Electricity retailers may offer customers terms and conditions that vary from the VDO. For most customers, the VDO will not be the best offer and they can access a market offer with better prices.

An Order in Council (pricing order) (see appendix A) gives the commission the role of regulating the tariffs for all standing offers and sets out the scope and requirements we must follow when making a VDO price determination.[6] On 25 November 2020 we made a price determination under the pricing order for 2021. This regulates the amounts retailers can charge customers on standing offers in Victoria in 2021.

We are seeking stakeholders' views on next steps for the VDO

There are two main issues we are seeking feedback on:

- how the current VDO price determination[7] should take into account changes to network tariffs applying from 1 July 2021;[8] and
- our approach for the next determination to apply from 1 January 2022.

These matters are covered in the same paper, as our approach to reflecting changes to network tariffs may impact on the process and issues for our next determination.

Reflecting changes to network tariffs in the VDO

The current VDO price determination was based on assumptions at the time about certain costs. This included the level and structure of network tariffs paid by Victorian electricity retailers, with certain approved network tariffs used to calculate network costs for the VDO. Network costs

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

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

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

[7] Applying from 1 January 2021 to 31 December 2021.

[8] These tariffs will be approved by the Australian Energy Regulator as part of transitioning to financial year pricing periods (from calendar year) for Victorian network distribution businesses.

account for around one third of the costs reflected in the VDO, and they are treated as a 'pass through' in our VDO methodology.[9] This is because retailers pay charges for using the network to deliver energy to their customers, and the charges are determined by a price regulator.

The Australian Energy Regulator (AER) recently made its final decision on the Victorian distribution network businesses' revenue requirements for the 2021-26 regulatory period. It also approved changes to the structure of network tariffs.[10]

While retaining flat and demand network tariffs, from 1 July 2021 new simplified time of use network tariffs will be the default network tariffs for all new connections, and for certain other customers.[11] In addition, all existing time of use and other flexible network tariffs will sunset (legacy tariffs), and customers on these tariffs will be automatically transferred to the new time of use network tariff structure and prices. Customers may opt out of the new tariffs, to either a flat network tariff or to a demand network tariff.[12]

The AER is expected to release its final decision on the network prices that will apply from 1 July 2021 in mid-June.

We propose a variation to the current VDO determination

We propose to vary the current VDO price determination to reflect the AER's final decision on network tariff structures and prices. The current VDO price determination nominates the AER's final decision on network tariffs as one of the circumstances under which we might vary VDO prices.[13]

We propose to vary the current VDO price determination to:

- **Update** the flat VDO tariff to reflect the new AER approved rates for flat network tariffs. The structure of the flat VDO tariff, and all other cost components (that is, but for network costs)

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[9] Essential Services Commission, Victorian Default Offer: Final decision, November 2020, p. 18.

[10] Australian Energy Regulator, Final decision - Powercor distribution determination 2021–26, April 2021; Australian Energy Regulator, Final decision - Citipower distribution determination 2021–26, April 2021, Australian Energy Regulator, Final decision – AusNet Services distribution determination 2021–26, April 2021, Australian Energy Regulator, Final decision - Jemena distribution determination 2021–26, April 2021; Australian Energy Regulator, Final decision – United Energy distribution determination 2021–26, April 2021.

[10] Specifically, those who upgrade to three phase power.

[11] Specifically, those who upgrade to three phase power supply, install solar PV, install batteries, or install electric vehicle fast chargers.

[12] With the exception of customers installing electric vehicle fast chargers.

[13] Essential Services Commission, Victorian Default Offer Price Determination: 1 January 2021–31 December 2021, November 2020, pp. 10-11.

would remain unchanged. This is consistent with the treatment of network costs as a pass through in our VDO methodology.

- **Introduce** a new two period time of use tariff VDO, which is calculated based on the new default time of use network tariff structure and prices approved by the AER. To set the new tariffs for this new VDO, all other cost components (that is, but for network costs) would adopt the values used to calculate the flat VDO tariff in the current price determination.
- **Update** the compliant maximum annual bill to reflect the new default time of use network tariffs approved by the AER (currently the compliant maximum annual bill is calculated based on the flat tariff VDO rates). This would regulate all standing offers not covered by the flat VDO tariff, or the proposed new two period time of use tariff VDO.

The introduction of a new two period time of use VDO to align with the new default time of use network tariffs should see more standing offer customers regulated through specified VDO tariffs, rather than through the compliant maximum annual bill. Generally, stakeholders in our past consultation processes preferred specified tariffs as they are more transparent and reduce compliance costs for retailers (compared to the compliant maximum annual bill). Accordingly, we consider our proposed approach will simplify the VDO consistent with objectives under the pricing order.[14]

Our proposed approach also allows standing offer customers currently on legacy time of use network tariffs to benefit from the new two-period time of use tariffs. These customers should be better off primarily due to the new time of use peak periods (3.00pm–9.00pm) having much shorter peak periods than many legacy network tariffs, as well as the network businesses rebalancing prices between flat and time of use tariffs (leading to lower network costs for time of use tariffs).[15]

We also consider the variation will provide for consistency between retail and network tariffs, which could lead to reduced financial risks for retailers as their retail tariffs better reflect underlying costs.[16]

We seek stakeholder feedback on our proposed approach. The main alternative to our proposal to introduce a new two period time of use VDO tariff is to continue to use the compliant maximum annual bill framework to regulate all non-flat standing offers, at least in the near term.

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[14] Clause 3 of the pricing order.

[15] Jemena in its tariff structure statement undertook analysis of its legacy time of use customers bill impacts of their proposed changes. Jemena's analysis covered the 18,529 customers on its legacy time of use tariffs who have consumption over 250kWh and below 40MWh.Out of these 18,529 customers, Jemena has 201 customers (1%) with bill increases, with the remainder having bill decreases.

[16] Clause 12.3 of the pricing order.

Variation proposed to take effect from 1 August 2021

We are proposing that the variation takes effect from 1 August 2021. There are benefits to aligning the VDO variation alongside the potential market contract price changes as of 1 August. This includes the option for retailers to bundle price notifications requirements potentially reducing the number of notifications customers receive. Feedback from consultation with retailers indicates that implementation from 1 August will help to streamline their customer price change notification processes, and thereby help to minimise their compliance costs.[17]

Our consultation on the proposed variation

We are proposing a relatively short consultation period on our proposed variation. We consider it is urgent to align the VDO with changes in network tariff structures and prices as soon as possible after 1 July 2021 (this is explored further from page 11 of this paper). Our process and timeframes have been tailored to what we consider most appropriate for making the price determination. This is consistent with the requirements of the pricing order[18] and the 2021 VDO price determination.[19] They also reflect the:

- extensive consultation we undertook in 2020 on options for reflecting anticipated changes in network tariffs in the VDO
- benefits of enabling new VDO tariffs to apply from 1 August 2021
- relatively narrow focus of our proposed variation (focusing on network tariffs only)
- treatment of network costs as a pass through in our VDO methodology.

Our Charter of Consultation and Regulatory Practice[20] provides principles we consider when undertaking stakeholder engagement. Our proposed timeframes are shorter than the indicative ones outlined in our charter of consultation and regulatory practice.[21] The processes and timelines for engagement outlined in this are however indicative only and are not suitable for our price determination variation process.

The key timelines we propose are set out below. We are seeking comment on our proposed approach to reflecting network tariffs in the current VDO determination by 25 May 2021. Before then, we also intend to host a forum with stakeholders to explore and receive stakeholder views.

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[17] Essential Services Commission Act 2001, s. 8A(1)(e).

[18] Clause 12.5 of the pricing order.

[19] Clause 6.5 of the 2021 VDO price determination.

[20] Developed and issued under section of the Essential Services Commission Act 2001.

[21] Essential Services Commission 2018, Stakeholder Engagement Framework: Charter of Consultation and Regulatory Practice, 27 June.

Table 1: Timeframes for the 2021 VDO variation

Key milestones	Indicative date
Public forum – consultation paper	20 May 2021
Submissions on consultation paper close: for the approach to variation only	25 May 2021
Draft variation determination released	9 June 2021
AER decision on network tariffs for 2021–2022 published	Mid-June (indicative only)
Submissions on draft variation determination close	mid-June 2021*
Final variation determination released	June/July2021*
Variation to 2021 VDO comes into effect	1 August 2021

* These timeframes are indicative only and may change depending on the timing of AER's decision on network tariffs.

We are also seeking feedback on our proposed approach to the 2022 VDO

The current VDO price determination will end on 31 December 2021. Under the pricing order, we must make a new determination by 25 November 2021 for the new VDO to apply from 1 January 2022.[22]

We consider using largely the same approach as we did in our current VDO price determination will best meet our legislative objectives and requirements. That determination was made in November last year and we consider the general approach we used meets all relevant provisions and matters we must have regard to under the *Essential Services Commission Act 2001* (Vic), *Electricity Industry Act 2000* (Vic) and the pricing order.

In our consultation on the 2022 VDO we will update estimates of costs reflected in the VDO for changes in market-based data, where relevant.

While stakeholders may wish to comment on any aspect of the VDO, we are particularly seeking feedback on matters we previously said we would consider in future reviews. Among other things,

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

we seek views on our approach to bad debts, and the length of the regulatory period from 1 January 2022. Table 2 provides indicative timelines for the 2022 VDO review.

Table 2: Timeframes for the 2022 VDO

Key milestones	Indicative date
Public forum – consultation paper	20 May 2021
Submissions on consultation paper close: approach to the 2022 VDO	16 June 2021
Draft decision on 2022 VDO released	September 2021
Draft decision on 2022 VDO – public forum	September 2021
Submissions on draft decision on 2022 VDO close	September/October 2021
Final decision and final determination on 2022 VDO	By 25 November 2021

How to provide feedback

We invite stakeholders to make submissions in response to this consultation paper.

Both general comments and formal submissions to our consultation paper should be made by:

- **5pm 25 May 2021** for the approach to variation to the current VDO determination
- **5pm 16 June 2021** for feedback on our approach to the 2022 VDO.

We may place lower weight on, or may not be able to consider, submissions received after these dates.

To make a submission on this paper please go to Engage Victoria's website: www.engage.vic.gov.au.

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

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

Addressing changes to network tariffs

This section sets our proposed approach for giving effect to changes to network tariffs, resulting from the AER's final decision on network prices to apply from 1 July 2021.

Network costs represent the costs of building, operating and expanding the electricity distribution and transmission networks. We are required to have regard to network costs in estimating efficient costs, with the charges levied by each of Victoria's five network distribution zones approved by the AER on an annual basis. Our current VDO methodology treats network costs as a pass through and uses the simplest network tariffs approved by the AER for each distribution zone.[23]

Network costs account for around one third of the costs reflected in the VDO.

The VDO currently includes flat tariffs and a maximum bill

We set VDO tariffs for domestic and small business customers in each of Victoria's five distribution zones. The flat VDO tariff currently includes:

- flat tariffs for both residential and small business customers
- flat tariffs with a controlled load for residential customers.

We also regulate standing offers that comprise tariffs that are not flat tariffs (or any combination of flat and non-flat tariffs) through a compliant maximum annual bill.[24] The pricing order requires retailers to ensure that the maximum annual electricity bill amount the customer is to pay under a variable tariff standing offer does not exceed the VDO compliant maximum annual bill.[25]

Flat VDO tariff

A flat tariff structure comprises a daily supply charge and a single usage charge calculated on a per kilowatt hour (kWh) basis.[26] The majority of retail offers, including standing offers, comprise flat tariffs. To achieve the flat VDO tariff, we allocate costs that vary with consumption to the usage charge, while costs that are fixed are allocated to the supply charge.

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[23] Essential Services Commission, Victorian Default Offer: Final decision, November 2020, p. 18.

[24] Non-flat tariffs include time of use and other flexible tariffs, as well as tariffs that include demand charges.

[25] Clause 10.2(a)(ii) of the pricing order.

[26] As defined in clause 4 of the pricing order, a flat tariff means a tariff for the supply or sale of electricity where the tariff components do not vary by reference to: (a) the time of day; (b) the amount of electricity distributed or supplied during the day; (c) temperature, whether actual or forecast; or (d) other characteristics that vary during the day. The Victorian Default Offer also includes a component for controlled load tariffs, where applicable.

Compliant maximum annual bill

In some instances, the underlying network tariff assigned to a meter for a standing offer may not be a flat tariff. In addition to setting flat VDO tariffs (described above), we regulate standing offers with non-flat tariff structures through a compliant maximum annual bill.

Retailers offering non-flat standing offer tariffs must ensure their tariffs do not result in a bill above the compliant maximum annual bill at a specific usage amount. The maximum annual bill retains the safeguard of the VDO to all standing offer customers, without removing the option of non-flat standing offer tariffs for customers who were receiving them prior to the introduction of the VDO.

We estimate only around 5,000 residential and 10,000 small business customers are currently on standing offers regulated by the compliant maximum annual bill. This compares to around 120,000 residential and 30,000 small business customers on the flat VDO tariff.[27]

Changes to network tariffs from 1 July 2021

On 30 April 2021, the AER made its final decision on the Victorian distribution network businesses' revenue requirements for the 2021–26 regulatory period.[28]

The AER also approved Victorian distribution network businesses plans to introduce simplified two-period (peak and off-peak) time of use network tariffs designed to better reflect the cost of network use. While retaining flat and demand tariff options, new network time of use tariffs with the following peak periods will be introduced:

- residential customers – 3pm to 9pm every day peak, and
- small business customers – 9am to 9pm business day peak.

In mid-June 2021, the AER is expected to publish its approved network tariff rates for the Victorian distribution network businesses to apply from 1 July 2021 to 30 June 2022.

From 1 July 2021, the new network time of use tariffs will be the default network tariffs for all new connections and those who upgrade to three-phase power supply, install solar PV, install batteries or install electric vehicle fast chargers . In addition, all existing time of use and other flexible network tariffs will sunset (legacy tariffs), and customers will be automatically transferred to the

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[27] Essential Services Commission, Government accepts regulator's advice on fair electricity price, accessed on 30 April 2021, https://www.esc.vic.gov.au/media-centre/government-accepts-regulators-advice-fair-electricity-price.

[28] Australian Energy Regulator, determinations and access arrangements, accessed on 30 April 2021, https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements.

new time of use network tariff structure and prices. Customers may opt-out to either a flat tariff or to a demand network tariff.[29]

Variation to the current VDO determination

The current VDO determination was based on assumptions at the time about certain costs. This included the level and structure of network tariffs paid by Victorian electricity retailers.

The pricing order provides that before or during a regulatory period, the commission may, on its own initiative, vary a VDO price determination in respect of the regulatory period.[30] We may vary a VDO price determination:

- 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
- to correct a clerical error, miscalculation, misdescription or other deficiency, or
- if any of the further circumstances for considering a variation outlined in clause 6.2 of the current VDO price determination, occur.

In our current VDO price determination, we used the tariffs approved by the AER for the period 1 January to 30 June 2021 which were published on 16 November 2020. The approved network tariffs for the second half of 2021 were not available at that time.

The current VDO price determination nominates the AER's final decision on network tariffs as one of the circumstances under which we might vary VDO prices.[31] Subject to the AER's final decision being issued by mid-June, we intend to vary the current VDO price determination to reflect and pass through changes in the network tariff structures and prices, to take effect from 1 August 2021 (see appendix B).

Flat tariffs

The current flat VDO tariff will be updated to reflect the new flat network tariff rates approved by the AER. This is consistent with our treatment of network costs and a pass through in the VDO methodology.

Should we not pass these costs through within the current VDO price determination we would need to update for them in the next VDO. The risks of delaying the pass through of these costs include that network costs would be lumpy (that is customers will pay their network costs over a shorter

[29] Customers that install electric vehicle fast chargers will not be able to opt out under the proposed rules.

[30] Clause 13(1) of the pricing order.

[31] Essential Services Commission, Victorian Default Offer Price Determination: 1 January 2021–31 December 2021, November 2020, pp. 10-11.

period). Further, we consider our approach has regard to the financial viability impacts of the AER's decision, given network charges are a large proportion of retailer costs.

Non-flat tariffs

Currently, there are a large range of non-flat network tariffs and retailers offer a variety of standing offer tariffs to mirror this. These standing offer tariffs are regulated by 29 compliant maximum annual bill amounts in the current VDO price determination.[32]

We propose to introduce a new two period time of use VDO with a tariff structure and prices that match the new network tariff structure. The tariffs for this new VDO will be calculated based on the customer usage profiles in Tables 3 and 4 below.

We propose to replace all existing compliant maximum annual bill arrangements with a compliant maximum annual bill arrangement based on the two-period time of use network tariff. This arrangement will apply to all non-flat tariff standing offers that are not the new two period time of use VDO. This arrangement will be like that provided in existing clause 5 of the current VDO price determination, except that the maximum annual compliant bill amount determined by the commission will be based on the two-period time of use network tariffs.

The introduction of a new two period time of use VDO to align with the new default time of use network tariffs should see more standing offer customers regulated through specified VDO tariffs, rather than through a compliant maximum annual bill arrangement. Generally, stakeholders in our past consultation processes preferred specified tariffs as they are more transparent and reduce compliance costs for retailers (compared to the compliant maximum annual bill). Accordingly, we consider our approach will simplify the VDO consistent with our objectives under the pricing order.[33]

The pricing order anticipates that we may, subsequent to our first VDO price determination made for 2020-21, change the manner pursuant to which standing offer tariffs may be determined or calculated.[34] Our proposal for regulating non-flat standing offers is consistent with this.

The main alternative to our proposal to introduce a new two period time of use VDO tariff is to continue to use the current compliant maximum annual bill framework, based on the updated flat network tariffs, to regulate the non-flat standing offers, at least in the near term. If we did not introduce the new two period time of use VDO tariff through a variation of the current VDO

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[32] Essential Services Commission, Victorian Default Offer Price Determination: 1 January 2021–31 December 2021, November 2020, pp. 15-19.

[33] Clause 3 of the pricing order.

[34] Clause 10(3) of the pricing order.

determination, then our intention is to introduce it for the next determination applying from 1 January 2022.

We seek stakeholder feedback on any risks, challenges or issues with regulating non-flat standing offers as we have proposed.

Proposed usage profiles for the two-period time of use VDO

To help retailers prepare for any change in standing offer tariffs we have determined the following usage profiles for the new two-period time of use VDO tariffs. We consider the updated usage profiles will promote consistency and reduce retailer compliance costs.

We calculated these usage profiles based on Manually Read Interval Meter data provided by AEMO. We have not observed any significant differences in these profiles across distribution zones.

We propose the following usage profiles will apply to the new two period time of use tariffs.

Table 3: Residential – Usage profile for two-period time of use VDO

Customer class	Peak period	Off peak
Time period window	3.00pm–9.00pm every day	All other times
Usage profile	0.34	0.66

Table 4: Small business – Usage profile for two-period time of use VDO

Customer class	Peak period	Off peak
Time period window	9.00am–9.00pm weekdays	All other times
Usage profile	0.62	0.38

Wholesale prices for the two-period time of use VDO

In calculating the tariffs for any new two-period time of use VDO, we considered whether we should calculate separate wholesale costs for the peak and off peak periods. Wholesale prices are normally higher during peak times than off-peak times.

The VDO is intended to apply as a safeguard for customers unable or unwilling to engage in the electricity retail market. At this point in time, we consider different wholesale costs for peak and off peak periods are not required given retailers do not hedge separately for different tariff types (such as VDO customers on time of use or flat tariffs).

We propose to continue to use our current approach to calculating wholesale costs. We propose to use the average wholesale costs rather than having separate wholesale costs for the peak and off-peak period. Under this approach retailers recover their efficient costs.

1 August 2021 effective date for the variation

We propose that the variation takes effect from 1 August 2021. There are strong benefits to align the VDO variation alongside the market contract price change on 1 August. These include bundling of price notifications to customers and reducing the compliance burden on retailers. It also provides for a relatively quick pass through of changes to retailer costs that will occur from 1 July 2021.

We prefer a variation to the determination

In our last determination, we said that if there are matters which materially affect our VDO cost stack or approach to VDO tariff structures, and it is practical to do so, we may make a new determination and revoke the 2021 VDO price determination.

A variation will allow us to quickly pass through the anticipated 1 July change in network tariffs. Under the revoke option, changes to network tariffs can only be passed through in late 2021.

We note market wholesale electricity prices have reduced since our current VDO price determination was issued.

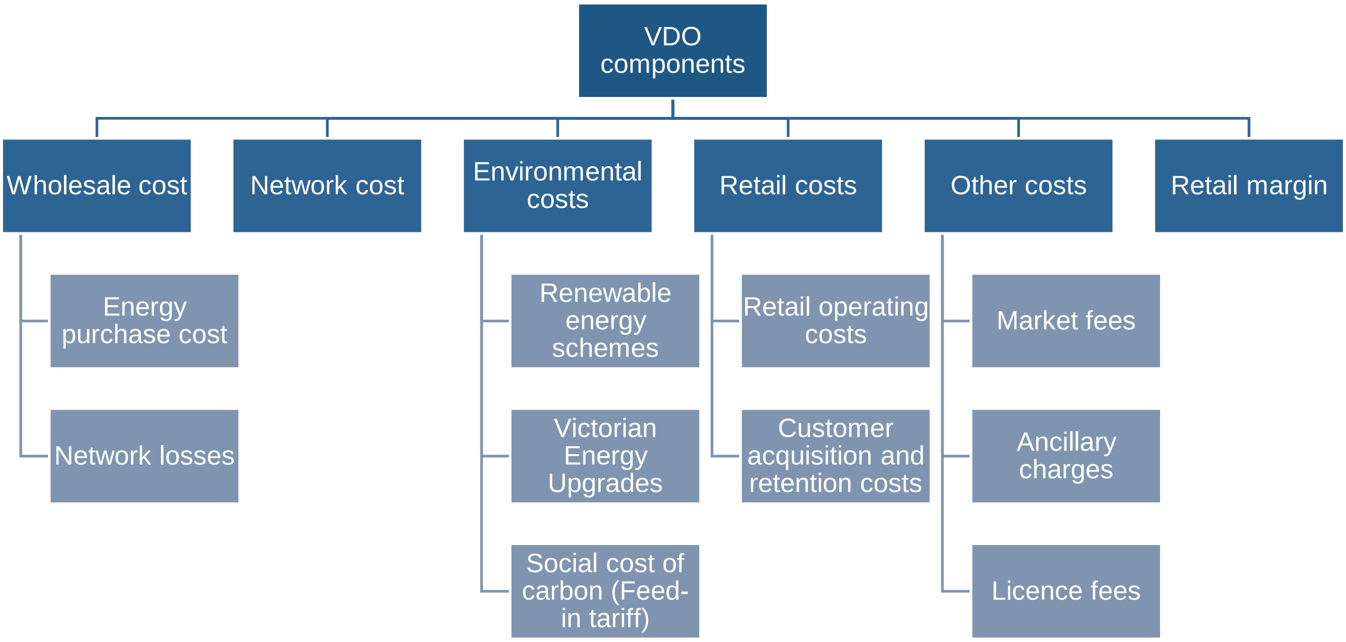
Wholesale costs are the second biggest component of the VDO after network costs. We base our assessment of wholesale prices on forecasts given retailers hedge their contracts well in advance. In some years, consumers will benefit from this uncertainty and in other years retailers will. While there has been a drop in wholesale contract prices, the impact on retailers' actual wholesale costs for 2021 is unclear. This is because our methodology considers the use of hedging in our assessment of wholesale costs. Given this hedging, wholesale costs will not reflect the full decrease in wholesale contract prices. As a result, it is unlikely that there would be a material benefit from passing through decreased wholesale costs for one or two months.

On the other hand, network tariffs are a known cost which are determined by a regulatory body. In the VDO tariffs, we pass through the published network tariffs directly. Not passing through the changes in network tariffs this year would not be consistent with our approach to network tariffs.

2022 VDO review: cost components

To set the Victorian Default Offer (VDO) tariffs, we must first estimate the efficient costs of providing retail electricity services to be recovered through those tariffs. Figure 1 sets out the key items we propose to include in our estimate of efficient costs.[35]

Figure 1: Cost items included in the VDO cost stack



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

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

As part of this review, the estimates included in the VDO cost stack will need to be updated to reflect changes in the market and new data that is now available.

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

We consider the methods used to estimate most cost items remain appropriate as we recently concluded the 2021 VDO process in November 2020. Prior to this, we reviewed the VDO prices twice in 2019. We would need to have strong new evidence to change our approach.

However, in our recent review of the VDO we identified a number of areas that we would explore further in future reviews. The rest of this section discusses the main areas of the VDO costs we are seeking feedback on.

Bad debts

> We will revisit the temporary allowance for bad debt expenses due to the coronavirus pandemic. While there is still uncertainty in relation to the final impact of the pandemic, there are some indications that retailers' financial provisions for bad debts in 2022 will be lower than they were for 2021. We seek stakeholder feedback on what information we should consider when we review the bad debt allowance, including supporting evidence where available.

Bad debts occur when customers cannot pay their electricity bills. Retailers may be able to recover some of these costs from customers however some of these debts will not be recoverable. Retailers should take steps to reduce their bad debts, such as through their payment difficulties policies, but regardless we would expect all retailers will have some bad debts.

In our last review we included an adjustment for increased bad debts

We accounted for the effect of the coronavirus pandemic on retailers' costs by increasing the amount in the VDO cost stack for bad debts as information provided by retailers suggested an increase in retailer bad debt expenses in relation to the pandemic.[36] This was also supported by economic forecasts which pointed to subdued economic conditions for at least the 2021 period.[37]

While our review accepted that retailers' bad debts expenses were likely to increase due to the pandemic, we also noted uncertainty as to how much the trend in arrears would flow through to bad debts in future years.

Since then bad debts are about the same as anticipated

We reviewed retailers' half yearly results in relation to bad debt provisions. These were about the same as or better than anticipated when we made our final decision in November 2020. Origin carried over its bad debt provisions, and AGL adjusted their bad debt provisions downwards by $5

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[36] Essential Services Commission, Victorian Default Offer 2021 - Final decision, November 2020, pp.29-31.

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

million. AGL's half year presentation to investors noted credit losses were tracking better than expected. However, both retailers noted the uncertainty in the market and the roll-back of some government supports in their estimates. [38]

However, information we have collected from retailers shows the average arrears for customers (who can and cannot pay for ongoing usage) continues to increase. There has also been a recent increase in disconnections and household debt. While bad debt expenses are still likely to be an issue, for this review we need to consider whether the amount of bad debts accrued will continue to be higher than historical levels in 2022.

We propose to monitor market conditions in relation to bad debts

We propose to monitor market conditions in relation to bad debt expenses, particularly given the rollback of a number of government supports, including Jobkeeper, before determining our position.[39] Current information on the economic outlook suggests that the additional allowance may not be required for the 2022 period.[40] However although the provisions that retailers have set aside for the current financial year are similar to the forecasts we considered last year, recent information shows the number of customers in debt and disconnections are increasing.

Wholesale cap contracts

Our initial view is to continue with Frontier Economics' approach using historical price movements to estimate cap contract prices. We will investigate using the data from the newly listed cap contracts for the draft decision once these contracts are sufficiently traded. Is there other information we should be considering in relation to the newly listed cap contracts?

Retailers must purchase electricity from the wholesale market to meet their customers demand for electricity. While some retailers own generators, many buy electricity directly from generators on the spot market. Buying electricity from the spot market exposes retailers to the risk that electricity prices may be high when they need to purchase electricity.

An efficient approach to managing this risk is the use of hedging. If a retailer hedges its wholesale electricity risk, the price they pay for electricity is set in advance or capped. Retailers can hedge by either contracting directly with a generator, or through a financial market – the futures market on

[38] AGL, 2021 Half year results: investor presentation, February 2021, p. 22; Origin, 2021 Half year report, February 2021, p. 19.

[39] Noting the objective of the VDO in clause 3 of the pricing order, and section 8A(1)(e) of the Essential Services Commission Act 2001, the commission will have regard to the benefits and costs of regulation for consumers, including low income and vulnerable consumers, and regulated entities.

[40] RBA, Statement on Monetary Policy, February 2021, p.1.

ASX Energy. Previously we have used prices from this financial market to estimate wholesale electricity costs, including wholesale cap contracts.

In our last review we were able to use cap contract prices from ASX energy

In our last review we were able to use cap contract prices from ASX energy for quarter one to quarter three of 2021. However, we did not have cap contract prices for quarter four. From 1 October 2021, base $300 cap contracts (which can be purchased up to four years in advance) were delisted from ASX Energy. This was due to AEMO's rule change on five-minute settlements in the National Electricity Market.

To address this issue, Frontier Economics assumed a price for $300 caps in the fourth quarter of 2021. Frontier Economics' approach considered the most recent information available, as well as the historical variance between quarter one and quarter four caps in determining a price.

ASX energy will introduce new cap contracts

ASX Energy has introduced new cap contracts (designed for a five-minute settlement) to replace the existing cap contracts in March 2021.

We propose to investigate the newly listed cap contracts for the draft decision

We will investigate using the data from the newly listed cap contracts for the draft decision once these contracts are sufficiently traded.

Retail operating margin

> Our initial view is to maintain the retail margin at 5.7 per cent. The information we have reviewed suggests the current margin is within a reasonable range. Should we be considering any other information?

The pricing order requires us to have regard to the retail operating margin when making a VDO price determination.[41] The retail operating margin represents the operating profit margin required to compensate investors for the capital provided to operate a retail service. It should be sufficient to

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

cover the cost of capital, and the systematic (non-diversifiable) risk associated with investment.[42] The retail operating margin is expressed as a percentage of the cost stack.[43]

In our last review we used a margin of 5.7 per cent

In our last review, we retained the regulatory benchmarking approach used in our previous decisions. We considered how the pandemic affected retailers' margins and whether the level or methodology of the retail operating margin in the VDO should change to reflect this. The retail operating margin accounts for systematic risk, such as market downturns due to a pandemic. Given there was insufficient evidence to suggest systematic risk had materially changed we did not increase the retail margin.

We also considered stakeholder submissions which queried whether the operating margin sufficiently accounted for efficient capital expenditure. We concluded that the current margin does adequately compensate retailers for cash outflows associated with efficient capital investments.

Our initial view is this margin continues to be appropriate

We propose to maintain the current retail operating margin for this review. The current margin sits within the range of other Australian domestic jurisdictions.[44] If new evidence arises that may suggest the required level of investment has changed, we may consider conducting a review into the retail operating margin.

During our last review stakeholders raised concerns that the retail margin might not adequately capture the risks and costs associated with the increased capital investment in retail electricity. Another submitted concern was that depreciation was not covered under the model. Other stakeholders recommended that we conduct independent modelling to determine an appropriate benchmark for an efficient retail operating margin. Given this, following our most recent review we investigated the current margin and the methodologies adopted by other jurisdictions.

We considered a range of evidence to assess the appropriateness of the current margin. Firstly, we re-assessed our model, and concluded it does account for depreciation and capital

[42] 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, and that we are not required to base retail operating margins on actual retailer operating margins.

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

[44] Independent Competition and Regulatory Commission (ACT), Queensland Competition Authority (QLD), Office of the Tasmanian Economic Regulator (TAS), Essential Services Commission of South Australia (SA) and Independent Pricing and Regulatory Tribunal (NSW) range from 5.3 to 5.7 respectively.

investment.[45] We then considered the margins reported by retailers.[46] On average the observed margins were approximately 5.7 per cent in 2018–19 and 5.9 per cent in 2017–18. We also investigated the margins used by other regulators. In other parts of Australia, where margins are explicitly accounted for, they range between 5.3 and 5.7 per cent.

We also looked at international regulators that set retail electricity prices. The most similar regimes we found were in the United Kingdom. However, due to market differences between Victoria and these jurisdictions we did not consider these values as fair comparisons.

The above evidence suggests the current margin is within a reasonable range. However, we will continue to monitor the margins reported by retailers, the decisions of other regulators, and changes in the market. We will also request further information from retailers on depreciation to understand whether retailers' depreciation expenses are changing.

Five-minute settlement

We consider the one-off increase to retail operating costs provided in the 2021 VDO adequately accounts for changes in the cost to serve relating to five-minute settlement.

We welcome stakeholder views on this, including supporting cost data.

From 1 October 2021, the settlement period for the electricity spot price will change from 30 minutes to five minutes. Five-minute settlement is designed to provide better price signals for investment in fast response technologies (batteries, new generation gas peaking power plants and demand response).[47] Retailers previously told us there are additional operating costs associated with this new national regulatory obligation, including upgrading retailer customer management systems – billing, metering and pricing functions.

In 2021 we included a small increase in retail costs for five-minute settlement

In making our 2021 determination, we sought stakeholder feedback on Victoria specific costs related to five-minute settlement, asking retailers to quantify the impact to their operating costs. From the information provided by retailers, most of the costs incurred appeared to relate to capital expenditure investments in existing operating systems. At the time we noted the retail margin

[45] The VDO allows for the benchmark retailer to undertake some level of capital expenditure. The regulatory benchmarking approach was cross-checked with expected returns approach that accounts for an estimated capital expenditure. The capital expenditure less depreciation was assumed to be 0.52% of expected total costs in each year.

[46] Confidential information submitted by retailers in relation to our cost data request.

[47] In November 2017, the Australian Energy Market Commission ruled to change the settlement period for the electricity spot price from 30 minutes to five minutes – commencing 1 October 2021.

already provides for capital depreciation associated with updating and maintaining operating systems, and we did not consider an additional allowance for capital expenditure to be justified.

However, retailers did provide information showing ongoing operating costs, and on the basis of the information provided we estimated an additional amount of $0.84 per year per customer, adjusted to reflect the commencement of the five-minute settlement obligation in October 2021. [48]

Our initial view is the current allowance adequately covers retailers for the cost of five-minute settlement implementation

We consider the one-off increase to retail operating costs provided in the 2021 VDO adequately accounts for any ongoing changes in the cost to serve relating to five-minute settlement.

We welcome stakeholder views, noting retailers should support any claims with Victoria specific operating cost data.

Large-scale renewable energy target costs

Our initial view is to retain the approach we used in the previous VDO decisions to estimate a benchmark for costs associated with the Large-scale Renewable Energy Target (LRET). This involves using available market data on the expected future costs of meeting the LRET.

In calculating the VDO we must have regard to environmental and other regulatory costs in establishing the efficient costs of the sale of electricity by a retailer.[49]

The LRET is one of the four main environmental costs faced by Victorian electricity retailers. It is a Federal Government policy designed to reduce emissions in the electricity sector and encourage additional generation from sustainable and renewable sources. It creates a financial incentive for the installation of renewable energy power stations.

Under the LRET, eligible large renewable power stations create large-scale generation certificates for every megawatt hour of power they generate. Electricity retailers, on the other hand, buy large-scale generation certificates to meet their legally binding renewable energy obligations. Electricity retailers then surrender these certificates to the Clean Energy Regulator in percentages, called Renewable Power Percentage, set by regulation each year.

[48] The change to five-minute settlement occurs from 1 October 2021 and only covers a single quarter of the 2021 VDO.

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

In 2021 we used market prices for Large-scale generation certificates

Our final decision on the 2021 VDO was to retain the approach we used in the 2020 VDO to estimate a benchmark for costs associated with the LRET.

Our approach involved multiplying the 2021 default renewable power percentage by the futures market price for large-scale generation certificates. We also included a true-up mechanism to account for the difference between the default renewable power percentage used in the 2020 VDO and the binding renewable power percentage for 2020.[50]

Further detail on our approach to calculate LRET costs is available in our final decision for the 2021 VDO.[51]

Our initial view is that we should continue to use market prices

To meet their LRET obligations, retailers purchase large-scale generation certificates from the futures market or through power purchase agreements. In previous reviews, some retailers submitted that we should use a weighted average of retailers' large-scale generation certificates costs noting the higher cost of large-scale generation certificates purchased by retailers through power purchase agreements. We have addressed this matter in our previous reviews.[52]

We note that since our last review, AGL has written down the value of their power purchase agreements as a result of declining wholesale electricity prices and large-scale generation certificates. It said:

> Our 1H21 result reflects the sharp decline in wholesale prices for electricity and large-scale renewable certificates over recent times, the impact of lower gross margin in Wholesale Gas, higher costs associated with the COVID-19 pandemic, and increased depreciation expense following recent investment.[53]

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[50] The binding renewable power percentage for 2021 was yet to be released when we finalised our 2021 VDO determination. As we did in our 2020 VDO price review, we have used the method set out by the Clean Energy Regulator to calculate a default renewable power percentage for 2021. A true-up mechanism is then used to account for any difference between the default and binding renewable power percentages for the relevant year.

[51] Essential Services Commission, Victorian Default Offer 2021 - Final decision, November 2020, pp. 19-26.

[52] Essential Services Commission, Victorian Default Offer 2020 - Final decision, November 2019, pp. 36-37; Essential Services Commission, Victorian Default Offer 2021 - Final decision, November 2020, pp. 19-26.

[53] AGL, ASX and media release, 1H21 results announcement, 21 February 2021, accessed 29 March 2021, https://www.agl.com.au/-/media/aglmedia/documents/about-agl/asx-and-media-releases/2021/210211_aglfy21halfyearresultsannouncement.pdf?la=en&hash=3CA9CACFB525FEB651BC97D8BC0D7D62.

We consider that retaining our approach to calculating LRET costs using future market prices for large-scale generation certificates best meets the requirements of the pricing order to estimate the efficient cost of complying with the LRET.

Productivity factor

Our initial view is to not include a productivity factor in the VDO in 2022.

The main purpose of a productivity factor is to reflect decreases in costs due to efficiency gains.[54]

In 2021 we did not use a productivity factor

In determining 2021 VDO prices, we raised the possibility of introducing a productivity factor to the retail operating cost component of the VDO.[55] However, our final decision on 2021 VDO prices did not adopt a productivity factor due to the uncertainty associated with the effect of the pandemic on retail operating costs, noting there could be merit in considering an efficiency mechanism in future reviews.

Our initial view is that we will not use a productivity factor at this stage

We have again considered the introduction of a productivity factor, noting retail operating costs appear to be falling.[56] Productivity data from the Australian Bureau of Statistics on retail trade also suggests there have been productivity improvements in the sector.[57] Our model currently adjusts for CPI which would already largely account for productivity improvements seen in retail trade.[58] One approach to embedding productivity into the VDO is to apply an efficiency factor to the retail operating cost component.[59] We note it is uncertain whether a productivity factor would provide any additional benefit at this point in time. A productivity factor would also need to be regularly reviewed to ensure it is capturing ongoing efficiencies.

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[54] Efficiency gains in the retail electricity market can be associated with reductions in the cost to serve due to labour productivity and improvements in information technology systems (such as billing functions).

[55] See Essential Services Commission 2020, Victorian Default Offer 2021: Draft decision, 15 September p. 23, and Essential Services Commission 2020, Victorian Default Offer 2021: Final decision, 25 November p. 34.

[56] Both AGL and Origin Energy have reported reduction in operating costs between 2017–18 and 2019–20.

[57] See the Australian Bureau of Statistics' Estimates of Industry Multifactor Productivity https://www.abs.gov.au/statistics/industry/industry-overview/estimates-industry-multifactor-productivity/latest-release.

[58] Our analysis showed productivity for retail services was not significantly different from CPI, which is what we use to escalate retail costs.

[59] For example, the Australian Energy Regulator uses labour productivity forecasts to assist its forecasting of productivity growth in electricity distribution – it derives its forecast using publicly available data on output and employment measures sourced from the Australian Bureau of Statistics.

Instead of introducing a productivity factor another approach may be to examine our current operating cost benchmark. However, we note there has been significant market volatility associated with the coronavirus pandemic, and it may be more appropriate to analyse the benchmark once market conditions have stabilised.

At this point in time, we intend to continue with our current approach of developing our cost data set. We consider a longer time series of cost data would support a review into the operating cost benchmark in the future.

Distribution and marginal loss factors

Our initial view is to update our approach to calculating distribution loss factors, using a weighted average of factors. We have not proposed changes to calculating marginal loss factors, but we will assess any views on the matter. We welcome stakeholder feedback on our approach to accounting for loss factors.

When electricity moves through transmission and distribution networks, some of it is lost in the process. Electrical losses are due to electrical resistance in the wires, converting some electricity to heat. These losses must be factored into any electricity purchased through the wholesale market to ensure supply meets demand. As a result, more electricity is generated than is consumed by end users. Marginal loss factors account for marginal losses in electrical power flow between a connection point (generation) and a regional reference node. Distribution loss factors account for average electrical energy losses for electricity transmitted between a transmission network connection point and a distribution network connection point.

In 2021 we updated our approach to distribution loss factors

For the 2021 VDO, we revised our approach to calculating and applying distribution loss factors. This was in response to concerns raised by EnergyAustralia who suggested that applying the short sub transmission factor did not reflect transmission loss in rural areas.[60] We explored the issue with Victorian distributors, and to better reflect the cost of supplying these customers, we updated our approach to accounting for distribution losses in the Ausnet and Powercor distribution zones. Rather than using only short sub-transmission factors, we used a simple average of both the short and long sub-transmission distribution loss factors in the Ausnet and Powercor regions.[61]

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[60] EnergyAustralia, submission to the Essential Services Commission Victorian Default Offer to apply from 1 January 2021: Draft decision, October 2020, p. 10.

[61] As published by the Australian Energy Market Operator, Distribution Loss Factors for the 2020-21 Financial Year, October 2020, p. 13.

We also considered each regional reference node (and its corresponding marginal loss) in both the rural distribution zones. EnergyAustralia submitted that much of its usage in the Powercor zone is greater than the marginal loss parameter we use.[62] Our research found a narrow range in factors across the Ausnet and Powercor zones.[63] Accordingly, we did not change our approach to accounting for marginal losses.

This year we will update the distribution loss factors for rural distributors

We are investigating the use of a weighted average approach to calculating distribution loss factors to apply to both Ausnet and Powercor regions. A weighted average approach may better reflect the losses incurred in servicing customers in rural areas. We intend to use data provided by distributors on both customer load and customers numbers, to ensure retailers servicing rural areas are adequately compensated for distribution losses.

At this stage, we are not planning to change our approach to accounting for marginal losses. Stakeholders have not previously suggested an alternative to our current approach, and we hold the view that the current approach, which uses the simple average of regional reference node factors for each distribution zone, adequately accounts for these losses.[64]

Network tariffs

For the 2022 VDO tariffs, in addition to specifying a flat VDO tariff, we propose to continue the default two-period time of use VDO as outlined in our proposed variation, reflecting changes to distribution network tariffs commencing 1 July 2021.

Proposed approach to account for network tariffs

We propose to continue to specify a flat VDO tariff with network tariffs as pass through costs. This is the same approach we used in our previous VDO determinations.

We also propose to include a two-period time of use VDO tariff to reflect the new network time of use tariffs approved by the Australian Energy Regulator (see discussion in the variation section). To calculate the two period time of use VDO tariff, we propose to use the usage profile in tables 3 and 4 and the proposed approach to calculating the wholesale costs above.

[62] EnergyAustralia, submission to the Essential Services Commission Victorian Default Offer to apply from 1 January 2021: Draft decision, October 2020, p. 10.

[63] Essential Services Commission 2020, Victorian Default Offer 2021: Final decision, 25 November, p. 21.

[64] As published by the Australian Energy Market Operator, Regional and Marginal Loss Factors: FY 2020-21, July 2020, p. 20.

This time of use VDO tariff will be simpler and easier to understand compared to existing or legacy time of use tariffs. Introducing a new two period time of use VDO tariff will enable retailers to offer this more cost reflective tariff to their customers.

We also propose to adopt the same approach we are proposing in relation to the compliant maximum annual bill for the variation.

Length of regulatory period

We seek feedback on the length of the 2022 VDO regulatory period: six months or 18 months.

The pricing order sets out that the regulatory period for a VDO determination is 12 months. Currently, VDO regulatory periods run on calendar years. However, the pricing order provides for the regulatory period to be extended or reduced if special circumstances exist. We must consult with the Minister for Energy, Environment and Climate Change before changing the length of the regulatory period.

From July network tariffs will change each financial year

The Victorian Government has passed legislation to align the regulatory periods for the Victorian network businesses with those for other jurisdictions to run on a financial year basis. The next regulatory period for the Victorian network business starts on 1 July 2021. We intend to align the VDO regulatory periods and Victorian network businesses' regulatory periods as soon as practical.

The next regulatory period starting 1 January to last for six months or 18 months

Network costs represent one of the largest parts of the VDO cost stack. In the 2021 VDO, they represent about 34 per cent of costs in the average residential bill (averaged across the five distribution zones).

We consider network costs should be treated as a cost pass-through. It is therefore desirable to align the regulatory periods for the VDO and network tariffs as soon as practically possible. This is beneficial for both retailers and consumers: retailers are able to immediately recover their actual costs associated with networks service while consumers are able to receive the benefits of lower network tariffs sooner (when applicable).

There are two options for the length of the regulatory period starting 1 January 2022: six months or 18 months. In our final decision for the 2021 VDO, we said that if the 2021 VDO determination continues to 31 December 2021, and there are no material changes to network tariff structures, we would expect the 2022 VDO regulatory period to last for six months, followed by 12-month regulatory periods.[65]

There are pros and cons relating to both options. The six-month regulatory period would allow us to align the timing of the VDO with changes to network tariffs sooner. A relatively shorter period

[65] Essential Services Commission, Victorian Default Offer 2020 - Final decision, November 2020, p. 51.

can also help to reduce the risk of forecasting uncertainty (for example, in relation to wholesale costs), and allow the VDO to change to reflect the latest estimates of efficient costs. The 2022–23 VDO review will have to start as soon as we complete the 2022 VDO review in November 2021.

While it might provide for greater price certainty for customers, an 18 month period may lead to a greater risk that estimates of efficient costs diverge from VDO estimates. This could mean larger price changes for VDO customers when they were next updated. A variation mechanism could address uncertain or unforeseen events that may have a material impact on the VDO, but accounting for material changes in the wholesale prices, for example, may not be straight forward. Relative to six months, an eighteen-month period may also help to lower the costs for stakeholders in terms of participating in VDO reviews (as we would be conducting one less review).

We seek your views on the length of the 2022 VDO regulatory period.

Abbreviations

Term	Definition
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASX	Australian Stock Exchange
ESC	Essential Services Commission
ICRC	Independent Competition and Regulatory Commission (Australian Capital Territory)
IPART	Independent Pricing and Regulatory Tribunal (New South Wales)
kWh	Kilowatt Hours
LGC	Large-scale Generation Certificate
LRET	Large-scale Renewable Energy Target
MWh	Megawatt Hour
NEM	National Electricity Market
PPA	Power Purchasing Agreement
RPP	Renewable Power Percentage
VDO	Victorian Default Offer

Appendix A – Order in Council

Victorian Government Gazette

No. S 208 Thursday 30 May 2019

By Authority of Victorian Government Printer

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

1. Purpose

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

2. Commencement

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

3. Objective of the Victorian default offer

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

4. Definitions

1. In this Order:

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

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

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

Example: A storage water heater is such an appliance.

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

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

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

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

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

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

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

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

(a) the time of day;

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

(c) temperature, whether actual or forecast; or

(d) other characteristics that vary during the day.

Notes:

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

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

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

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

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

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

kWh means kilowatt hour;

Minister means the Minister administering the Act;

MWh means megawatt hour;

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

Order means this Order;

prescribed customer: see clause 5;

quarter means a period of 3 consecutive months;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2. Despite subclause (1), in:

(a) clause 6;

(b) clause 7;

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

(d) schedule 1; and

(e) schedule 2,

the following definitions instead apply:

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

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

Notes:

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

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

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

5. Declaration of Prescribed customers

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

(a) a domestic or small business customer;

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

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

6. Victorian default offer tariffs

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

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

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

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

(a) a flat tariff; or

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

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

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

7. Retailer must make Victorian default offer

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

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

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

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

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

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

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

(a) are not flat tariffs; or

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

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

8. Information about the VDO on electricity bills

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

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

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

9. Conferral of functions and powers on the Commission

1. For the purposes of Part 3 of the ESC Act and section 12(1)(b) of the Act, the supply or sale of electricity under the Act is specified as prescribed goods and services in respect of which the Commission has the power to regulate prices.

2. The Commission may not make a price determination regulating tariffs for the supply or sale of electricity under the Act except as contemplated under this Order.

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

10. Commission to make VDO price determination

1. At least 37 days before the commencement of a regulatory period, the Commission must make a price determination in respect of the regulatory period that determines, for each distribution zone in Victoria:

(a) the tariffs, or the maximum tariffs, a retailer may charge prescribed customers under a standing offer during the regulatory period; or

(b) the manner in which the tariffs, or the maximum tariffs, a retailer may charge prescribed customers under a standing offer during the regulatory period are to be determined or calculated.

2. Without limiting subclause (1), the price determination that the Commission makes in respect of the first regulatory period:

(a) must determine:

i. the standing offer tariffs that are to apply in respect of flat tariffs, including, in the case of domestic customers, both flat tariffs and flat tariffs with a controlled load tariff; and

ii. in the case of a prescribed customer who is on:

A. a tariff that is not a flat tariff; or

B. any combination of a flat tariff, and a tariff that is not a flat tariff,

the maximum annual electricity bill amount that the prescribed customer is to pay under a standing offer in the regulatory period (***VDO compliant maximum annual bill***); and

(b) may provide, in the case of the customers specified in subclause (2)(a)(ii), for how any overpayment by those customers in that regulatory period, or any year (or part year) thereof, is to be dealt with; and

(c) may also include any other decisions or determinations that are required by this Order.

3. Despite subclause (2), the Commission may after its first price determination, determine another manner pursuant to which the standing offer tariffs referred to in that subclause are to be determined or calculated.

11. Regulatory periods for VDO price determinations

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

12. Approach and methodology for making a VDO price determination

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

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

   retail operating costs, including modest costs of customer acquisition and retention;
   (d) retail operating margin; and
   (e) subject to subclause (10), any other costs, matters or things the Commission, in the exercise of its discretion, considers appropriate or relevant.

   Note: Section 33(3)(e) of the ESC Act similarly requires the Commission to have regard to any other factors that it considers relevant.
5. The VDO compliant maximum annual bill must be based on:
   (a) the standing offer tariffs that the Commission determines are to apply in respect of flat tariffs; and
   (b) the prescribed customer's electricity usage.
6. For the purposes of subclause (4)(d), the Commission must, in the exercise of its discretion, determine the amount of modest costs of customer acquisition and retention.
7. For the purposes of subclause (4)(e), the Commission must, in the exercise of its discretion, determine a maximum retail operating margin, and in doing so must have regard to (without limitation) the principle that the margin must not compensate retailers for risks that are compensated elsewhere in the costs.
8. Subclauses (3), (4), (5) and (6) do not require the Commission to determine tariffs based on the actual costs of a retailer.
9. Subclause (7) does not require the Commission to determine tariffs based on the actual retail operating margin of a retailer.
10. In making a VDO price determination the Commission must not include headroom.
11. Section 33(4)(a) of the ESC Act does not apply to the making of a VDO price determination.
12. Otherwise, section 33 of the ESC Act applies to the making of a VDO price determination only to the extent that the section is not contrary to this Order.

    Notes:

    1. This Order, as an 'empowering instrument' in terms of the ESC Act, can modify the application of section 33 of the ESC Act: see section 33(1) of the ESC Act.
    2. Pursuant to section 33(3)(d) of the ESC Act, the Commission must have regard to relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries.

13. Variation of VDO price determinations

1. Before or during a regulatory period, the Commission may, on its own initiative, vary a VDO price determination in respect of the regulatory period.
2. The Commission must specify, in a VDO price determination, the circumstances under which the Commission will consider, and the basis on which the Commission will decide on, a proposed variation and (subject to subclauses (4) and (5)) the processes to be followed to enable the Commission to make such a variation.

3. Without limiting subclause (1), the Commission may vary a VDO price determination:
   (a) if an event has occurred or will occur that was uncertain or unforeseen by the Commission at the time of making the VDO price determination; or
   (b) to correct a clerical error, miscalculation, misdescription or other deficiency.
4. Before making a variation, the Commission must consult in accordance with clause 14.
5. Subclause (4) does not apply if:
   (a) the variation is not sufficiently material to warrant consultation in accordance with clause 14; or
   (a) the need for the variation is sufficiently urgent to warrant consultation in accordance with clause 14 not being undertaken.
6. If, as a result of a variation of a VDO price determination, a retailer is or will be required to vary the retailer's standing offer tariffs, the Commission must ensure the retailer is given adequate notice before the variation to the VDO price determination takes effect.

14. **Consultation**
   1. The Commission may decide the nature and extent of stakeholder consultation it will undertake when making a VDO price determination or a decision to vary a VDO price determination.
   2. For the purposes of subclause (1), the Commission must have regard to its Charter of Consultation and Regulatory Practice (as amended from time to time) developed and published under section 14 of the ESC Act.

15. **Victorian default offer tariffs to be the reference tariffs for discounts**
   1. This clause applies until such time as the amendments to the Energy Retail Code required by clause 16(2)(a) come into force.

      Provided that, if those amendments do not provide for any matter provided for in this clause, then this clause continues to apply in respect of that matter.
   2. A retailer that offers a discount to a domestic customer or a small business customer must:
      (a) if the discount is in respect of the period from 1 July 2019 to 31 December 2019, disclose how the discount is calculated as against the tariffs in Schedule 1 or Schedule 2 (as the case may be), and what (in percentage or dollar terms) the reduction in tariff is in terms of those tariffs; and
      (b) if the discount is in respect of a regulatory period, disclose how the discount is calculated as against the flat tariffs determined by the Commission pursuant to the VDO price determination that applies in respect of that period, and what (in percentage or dollar terms) the reduction in tariffs is in terms of those tariffs.
   3. For the purposes of subclause (2), the reduction in tariffs is to be expressed as the difference between the estimated annual cost of the Victorian default offer for the customer type and distribution zone, and the estimated annual cost of the offer to which the discount relates after the discount is applied, using the annual reference consumption.
   4. For the purposes of subclause (3):
      (a) the estimated annual cost of the Victorian default offer is:
         i. during the period from 1 July 2019 to 31 December 2019, determined by applying Schedule 3;
         ii. during a regulatory period, determined by applying Schedule 3 or any other approach or methodology determined by the Commission; and
      (b) the retailer must determine the estimated annual cost of the retailer's offer to which the discount relates:
         i. if the tariff is a flat tariff or a flexible tariff (in either case, with or without a controlled load), by applying Schedule 3;
         ii. otherwise, based on a reasonable estimate having regard to any relevant information available to the retailer; and
   5. The annual reference consumption is:
      (a) during the period from 1 July 2019 to 31 December 2019:
         i. for domestic customers without a controlled load – 4,000 kWh general usage per annum;
         ii. for domestic customers with a controlled load – 4,000 kWh general usage plus 2,000 kWh controlled load usage per annum;
         iii. for small business customers (with or without a controlled load) – 20,000 kWh general

usage per annum.

(b) during a regulatory period:

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

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

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

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

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

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

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

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

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

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

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

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

i. all offers of discounts by retailers; and

ii. the advertising in respect of those discounts.

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

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

i. the discounted tariffs offered by a retailer; and

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

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

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

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

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

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

SCHEDULE 1

Victorian default offer tariffs for period from 1 July 2019 to 31 December 2019 – domestic customers
Charges are inclusive of GST.

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

SCHEDULE 2

Victorian default offer tariffs for period from 1 July 2019 to 31 December 2019 – small business customers
Charges are inclusive of GST.

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

SCHEDULE 3

1. **Estimated annual cost for flat tariff offers**

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

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

where:

EAC is the estimated annual cost of the offer;

SC is the supply charge;

UC is the general usage charge; and

ARC is the annual reference consumption for general usage.

2. **Estimated annual cost for flexible tariff offers**

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

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

where:

EAC is the estimated annual cost of the offer;

SC is the supply charge; and

ARC is the annual reference consumption for general usage;

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

UC_P is the retailer's peak usage charge;

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

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

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

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

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

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

where:

EAC is the estimated annual cost of the offer;

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

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

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

Table 1 – Usage allocation for flexible tariffs

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

Dated 28 May 2019 Responsible Minister

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

PIETA TAVROU

Clerk of the Executive Council

Electricity Industry Act 2000

MINISTERIAL ORDER UNDER SECTION 35(3B)

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

1. Commencement

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

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

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

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

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

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

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

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

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

4. Expiry of this Order

This Order expires on 31 March 2020.

Dated 22 May 2019

HON. LILY D'AMBROSIO MP

Minister for Energy, Environment and Climate Change

Appendix B – Summary of proposed changes to the current VDO price determination

Standing offer tariffs	Current	Proposed	Implications
Flat VDO	Flat VDO tariffs[66]	Flat VDO tariffs based on updated flat network tariffs.	Tariffs in schedules 1 and 2 will need to be updated
Compliant maximum annual bill (CMAB)	CMAB for 5 non-flat standing offer tariffs calculated based on flat VDO tariffs,[67] and customer usage profiles,[68] determined by the commission. CMAB for all other non-flat standing offers tariffs calculated based on flat VDO	CMAB for all non-flat standing offer tariffs, other than the two-period time of use VDO, to be replaced with a CMAB based on the two-period time of use tariffs determined by the commission.	Clause 4 and 5, and Schedules 3, 4 and 5 will cease to apply from 1 August 2021 A new clause 8 will be inserted into the current price determination to deal with all TOU standing offers that are not the two period time of use VDO. This will set out what the CMAB will be for these standing offers and what retailers need to do to ensure compliance. This will be effective from 1 August 2021.
Two-period time of use VDO		A two-period time of use VDO for residential and small business customers. Usage charges to be allocated to the two different tariff periods based on the proposed customer usage profile in our decision. Tariffs to be determined by the commission.	A new clause 7 will be inserted into the current price determination for our two period time of use VDO proposals. This will be supported by three new schedules outlining the new tariffs to apply to domestic and small business customers on this new VDO and related customer usage profiles. This will be effective from 1 August 2021.

[66] Essential Services Commission, Victorian Default Offer Price Determination: 1 January 2021–31 December 2021, November 2020, Schedule 1 and Schedule 2.

[67] Essential Services Commission, Victorian Default Offer Price Determination: 1 January 2021–31 December 2021, November 2020, Schedule 3.

[68] Essential Services Commission, Victorian Default Offer Price Determination: 1 January 2021–31 December 2021, November 2020, Schedule 3.