

Victorian Default Offer 2023-24

Draft Decision Paper

15 March 2023



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Summary

- Our draft decision for the 2023-24 Victorian Default Offer results in higher prices than the current prices in the 2022-23 Victorian Default Offer.
- The average annual bill for domestic customers on the Victorian Default Offer would be 31.1 per cent higher.
- The average annual bill for small business customers on the Victorian Default Offer would be 33.2 per cent higher.
- The change in prices is due to significant increases in wholesale electricity costs.
- In making our final decision we will update the data we use to set our cost benchmarks, including our wholesale electricity cost benchmark.
- We are seeking feedback on our draft decision by 11 April, to be considered for our final decision which will be made by 24 May 2023.

The Victorian Default Offer regulates standing offer prices

The Victorian Default Offer was introduced by the Victorian Government in a Governor in Council Order made under section 13 of the Electricity Industry Act 2000 (pricing order).¹ The Victorian Default Offer regulates standing offer² prices for electricity in Victoria supplied and sold to domestic customers³ or small business customers⁴. The first Victorian Default Offer was set by the Victorian Government in 2019 based on advice prepared by us. Our first determination of Victorian Default Offer prices came into effect 1 January 2020. We have been responsible for setting Victorian Default Offer prices since then.

¹ The Order in Council made under section 13 of the Electricity Industry Act 2000 was published in the Victorian Government Gazette No. S 208 on Thursday 30 May 2019.

² A standing offer is defined in section 3 of the Electricity Industry Act 2000.

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

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

The Victorian Default Offer provides a safeguard for customers

As the Victorian Default Offer is intended to be a reasonable price, it provides an important safeguard for customers who may be on a standing offer contract and disengaged from the market.

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

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

The Victorian Default Offer specifies the prices that may be charged for standing offers. Around 400,000 households and 55,000 small businesses are on standing offers.⁵ This represents around 15 per cent of households and 19 per cent of small businesses. This is an increase from 12 per cent of households and 17 per cent of small businesses in June last year. We note that recent increases in the number of standing offer customers are due to two major retailers moving fixed-term retail contract customers onto standing offers at the end of their contract periods. This has been behind most of the recent increase in standing offer customers over the last year.

Since September 2020, the Victorian Default Offer has also applied as a maximum price for most embedded network customers (covering around 150,000 customers).⁶ Electricity providers in embedded networks may set prices below the Victorian Default Offer.

The Victorian Default Offer also acts as a comparison price

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

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

⁵ Data collected through voluntary reporting from retailers in December 2022.

⁶ Embedded networks supply electricity for many domestic and small business customers in apartment buildings, caravan parks or office blocks.

We must review prices before the end of each regulatory period

We released our previous determination on 24 May 2022 for the Victorian Default Offer to apply from 1 July 2022 to 30 June 2023. We refer to these arrangements for standing offers as the 2022–23 Victorian Default Offer.

Under the pricing order, we must make a new determination for the Victorian Default Offer to apply from 1 July 2023 to 30 June 2024 on or before 24 May 2023.⁷ We refer to the new pricing arrangements for standing offers to apply from 1 July 2023 as the 2023–24 Victorian Default Offer.

In making our determinations for the Victorian Default Offer, we are guided by the requirements of the pricing order. We must adopt an approach and methodology that best meets the objective of the Victorian Default Offer as stated in the pricing order. This objective is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.⁸

High wholesale costs are increasing the Victorian Default Offer prices

The annual domestic bill in our draft decision for the 2023–24 Victorian Default Offer is roughly 31 per cent higher than those in the 2022–23 Victorian Default Offer (on average across Victoria's five distribution zones). The increase for small business bills is 33 per cent. In the 2023–24 Victorian Default Offer, wholesale electricity costs make up 36 per cent of the total bill for domestic customers and 37 per cent for small business customers.

Forecast wholesale electricity costs for 2023–24 started increasing significantly in May 2022. And although forecast costs have decreased since then, they are still much higher than they were at this time last year. This is shown in figure 3 below.

⁷ Clause 10(1) of the pricing order.

⁸ Clause 3 of the pricing order.

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

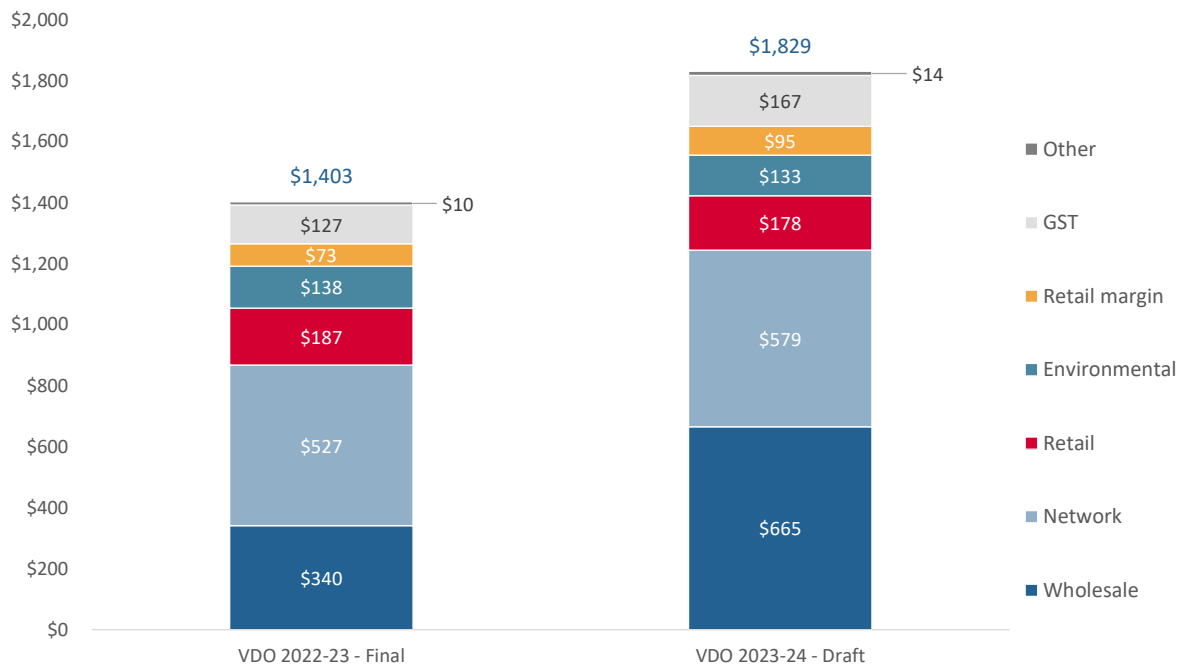
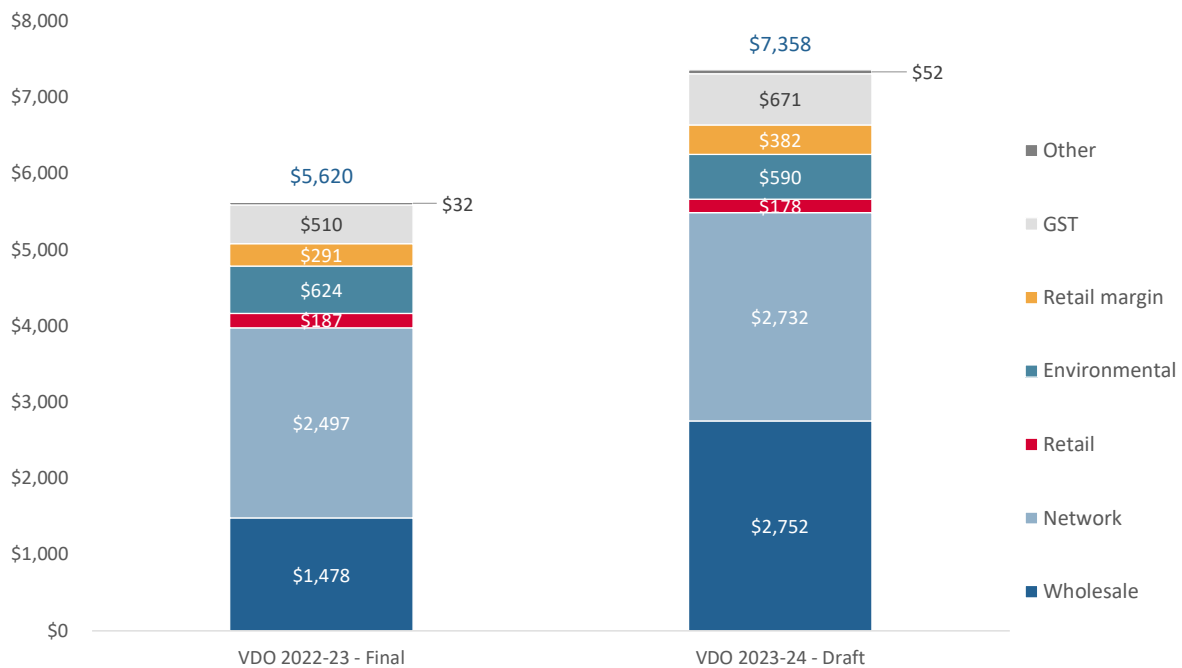
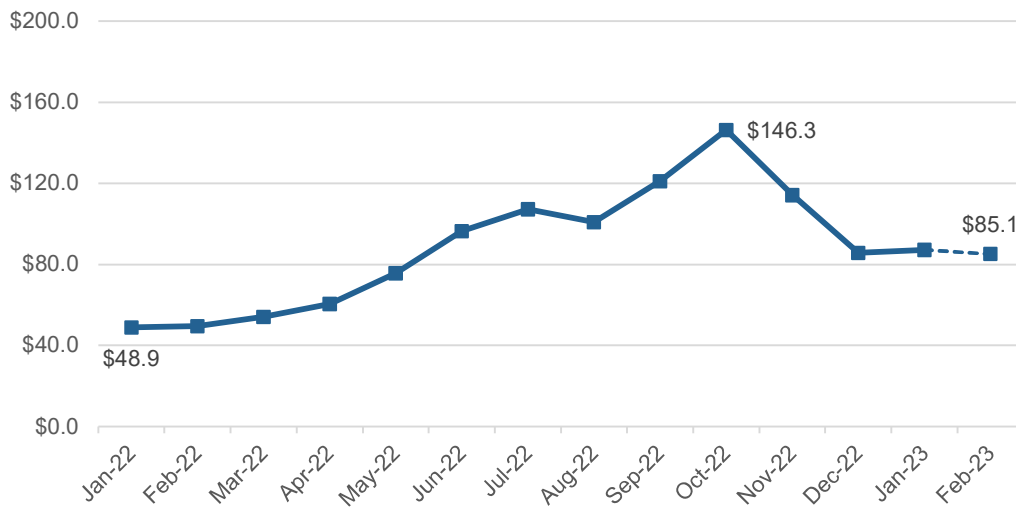


Figure 2: Change in Victorian Default Offer annual bills for small business customers (assuming annual usage of 20,000kWh)



Summary

Figure 3: Average monthly price of Victorian base swaps for 2023-24 (\$/MWh)



Source: ASX Energy: Tradelog and ESC analysis

Note: February 2023 data only includes contracts up to February 10th.

We acknowledge these expected increases in prices will be tough on Victorian energy consumers and we do not propose an increase in the Victorian Default Offer prices lightly. While our draft decision will lead to higher prices in the short term, setting the Victorian Default Offer prices at levels that reflect retailers' efficient costs will lead to lower prices in the medium to long term. Allowing retailers to recover efficient costs will help avoid costly retailer of last resort events, such as those that affected the United Kingdom in financial year 2021–22.⁹ It will also ensure that retailers continue to invest in the industry to drive the types of innovation that lead to long-term sustainable cost-efficiencies.

We understand that in the short term, increases in energy prices leading to higher bills for Victorians will be of concern in the community, and we urge Victorians to take advantage of government support programs offering power price relief.

A new round of the Victorian Government's Power Saving Bonus will open on 24 March, providing \$250 to Victorian households to help ease cost-of-living pressures and encourage consumers to compare energy offers.

⁹ Ofgem, Open letter: Review of how the costs of supplier failure are recovered, 7 July 2022, Available at: <https://www.ofgem.gov.uk/sites/default/files/2022-08/Follow%20up%20on%20our%20review%20into%20the%20arrangements%20for%20recovering%20the%20costs%20of%20supplier%20failure%20.pdf> [last accessed 8 March 2023].

Also, under the Energy Retail Code of Practice, all customers are entitled to receive payment assistance when they need it.¹⁰ Retailers can help customers that are having trouble paying their bills by providing payment plans and help in accessing concessions, rebates and utility relief grants that might be available.

We are seeking stakeholders' views on the Victorian Default Offer

For our draft decision on the 2023-24 Victorian Default Offer we have used largely the same approach as we did in the 2022-23 Victorian Default Offer. This approach meets the requirements of all relevant provisions and accounts for all matters we must have regard to under the *Essential Services Commission Act 2001*, *Electricity Industry Act 2000* and the pricing order.

In making our draft decision we have updated our cost benchmarks to reflect changes in costs. When we make our final decision we will update our data again. Table 1 below shows the differences between our draft decision for the 2023-24 Victorian Default Offer and the 2022-23 Victorian Default Offer. We seek feedback on the proposals, but stakeholders may also wish to comment on any other aspect of the Victorian Default Offer.

Table 1 Changes proposed in our draft decision for the 2023-24 Victorian Default Offer

Item	Past approach	Proposed approach
Market intervention costs	We include other market fees and charges from the Australian Energy Market Operator in the 'other costs' benchmark when determining Victorian Default Offer prices.	<p>We propose to include market intervention costs in the Victorian Default Offer 'other costs' benchmarks. These costs reflect the efficient costs of the sale of electricity by a retailer.</p> <p>We will include all known costs in the 2023-24 Victorian Default Offer.</p> <p>Costs that are determined after our decision will be included in following Victorian Default Offers.</p>
Retail operating costs	Estimated based on a benchmark set by the Independent Competition and Regulatory Commission in 2017 and adjusted for the change in the consumer price index since 2017.	<p>We propose to use the customer weighted average of retailers' actual retail operating costs (adjusted for changes in the consumer price index).</p> <p>We are of the view that this will better reflect the efficient costs of the sale of electricity by a retailer than the retail operating cost benchmark we used for the 2022-23 Victorian Default Offer.</p>

¹⁰ Energy Retail Code of Practice, Version 2, 1 October 2022, part 6.

Wholesale costs	Estimated using the trade weighted average price of contracts on ASX Energy from all days over the past twelve months	<p>We propose to use the trade weighted average price of contracts from all days over the past twelve months, except for the days options are exercised.</p> <p>This will help improve the accuracy of our wholesale cost forecasts.</p>
Consultation papers	We have published a consultation paper at the start of almost every Victorian Default Offer review.	<p>We propose to publish a brief 'request for comment' notice at the start of our future reviews (rather than a consultation paper).</p> <p>This will help streamline the early stages of our Victorian Default Offer review consultation processes.</p>

Table 2 provides indicative timelines for the 2023–24 Victorian Default Offer review.

Table 2: Timeframes for the 2023–24 Victorian Default Offer

Key milestones	Indicative date
Draft decision released	15 March 2023
Public forum on the draft decision	late-March 2023
Submissions on the draft decision close	11 April 2023
Final decision and determination	By 24 May 2023

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 11 April 2023. We may place lower weight on, or may not be able to consider, submissions received after these dates.

Visit Engage Victoria's website to make your submission: www.engage.vic.gov.au.

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

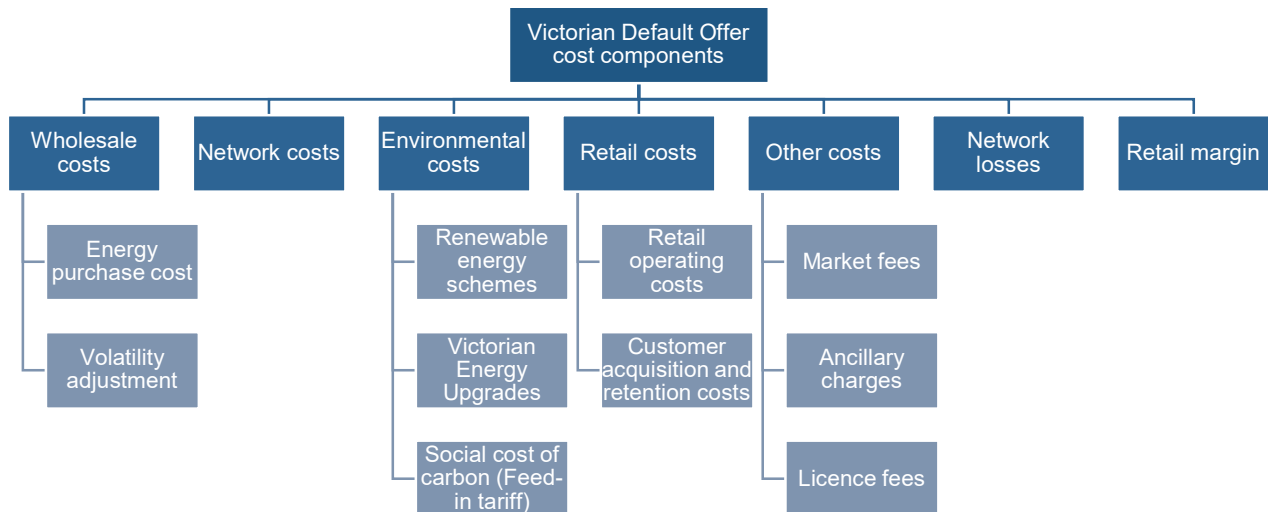
Sensitive or confidential information

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

Victorian Default Offer cost components

We must base the Victorian Default Offer on the efficient costs of the sale of electricity by a retailer.¹¹ In doing this, we must have regard to set cost components in setting tariffs.¹² The costs included in our Victorian Default Offer cost model are shown below.

Figure 4: Cost items included in the Victorian Default Offer cost stack



We use a number of different approaches to estimate the benchmarks for the costs used to calculate the Victorian Default Offer prices, including:

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

¹¹ Clause 12(3) of the pricing order.

¹² Clause 12(4) of the pricing order.

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

As in past years, we have collected cost data from retailers using our compulsory information gathering powers.¹³ This year we collected information from all retailers in Victoria with more than 10,000 domestic and/or small business customers.

Wholesale electricity costs

- Our draft decision is to use forecasts of wholesale electricity prices based on futures prices from ASX Energy. This was our approach in the 2022–23 Victorian Default Offer price determination.
- Wholesale electricity purchase costs make up around 36 per cent of an annual domestic bill (averaged across the five distribution zones).
- Wholesale electricity costs in our draft decision are 95 per cent higher than those in the 2022–23 Victorian Default Offer cost stack for domestic users.

We forecast electricity prices will be higher

Energy purchase costs are incurred by retailers when they purchase electricity from the wholesale market to meet demand from their customers. The pricing order requires us to have regard to the efficient costs of providing retail electricity services, including wholesale electricity purchase costs.¹⁴ We have used a futures market approach to estimate a benchmark energy purchase cost for 2023–24. The futures market approach is based on an estimate of the costs that a retailer would face in supplying electricity to their customers using financial hedging products purchased on ASX Energy. We used this approach in previous Victorian Default Offer determinations.

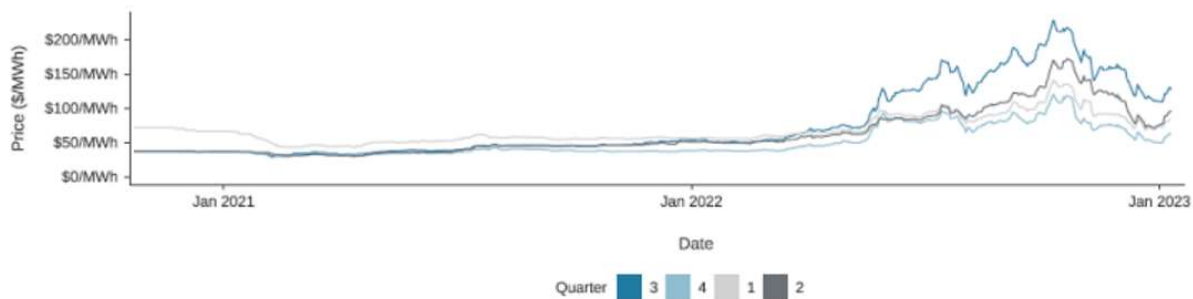
Our draft decision forecast for wholesale electricity costs is 95 per cent higher than the benchmark adopted for the 2022–23 Victorian Default Offer. The main driver for the change is increased wholesale electricity contract prices (figure 5).¹⁵

¹³ *Essential Services Commission Act 2001*, Section 36

¹⁴ Clauses 12(3) and 12(4) of the pricing order.

¹⁵ Frontier Economics, Wholesale electricity costs for 2023–24: A draft report for the Essential Services Commission, February 2023, p. 28.

Figure 5: Daily settlement price of Victorian base swaps for 2023–24



Source: Frontier Economics analysis of ASX Energy data, *Wholesale electricity costs for 2023–24: A draft report for the Essential Services Commission*, February 2023, p. 28.

The federal government has recently introduced gas and coal price caps as measures to limit volatility in the electricity market and to suppress high prices. Following the announcement of these policies wholesale electricity contract prices have decreased from their peaks. However, as electricity retailers typically buy hedging contracts to lock in their wholesale costs in advance, the highest prices from the middle of 2022 will contribute to higher wholesale costs for 2023-24. This is reflected in our approach to wholesale costs.

We use trade weighted contract prices from the last twelve months to develop our wholesale cost benchmark. This means the cost of all contracts traded during the last twelve months, including contracts traded while wholesale prices were at their peak, will contribute to our wholesale cost benchmark. But at the same time the lower prices from the end of 2022 will also contribute to our wholesale cost benchmark. This means the increase in wholesale costs is lower than it would have been had the highest prices persisted for all of 2022 and early 2023.

We will update our forecasts for our final decision. The current global uncertainty and volatility in fuel prices could mean that the wholesale cost benchmark adopted in our final decision is different to the one adopted in our draft decision.

Retailers buy electricity in the wholesale market

Electricity generators supply wholesale electricity to the National Electricity Market which matches generation with demand in real time. Electricity retailers must secure a supply of wholesale electricity. Some retailers own generators, but many buy electricity directly from generators on the spot market.¹⁶ Buying electricity from the spot market exposes retailers to the risk that electricity

¹⁶ The spot market is the mechanism that the market operator uses to match the supply of electricity from power stations with real time consumption by households and businesses. All electricity in the spot market is bought and sold at the spot

prices may be high when they need to purchase electricity. Hedging is a way of managing this risk. If a retailer hedges its wholesale electricity risk, the price it pays for electricity is set in advance or capped. Retailers can hedge by either contracting directly with a generator, or through a financial market transaction on ASX Energy, or with another financial intermediary.

Futures prices are transparent as they are publicly traded. Also, anyone can access contracts available through ASX Energy.

Frontier Economics estimated wholesale electricity costs

We engaged Frontier Economics to estimate wholesale electricity purchase costs. We have considered their approach and accept that Frontier Economics' recommendations reflect an appropriate benchmark of the efficient wholesale electricity purchase costs for estimating Victorian Default Offer prices. A full description of Frontier Economics' methodology, including data sources, is included in their report.¹⁷ A summary of the method is provided below.

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

To forecast demand and the relationship between price and demand, Frontier Economics begins by analysing historical data on load and prices. Based on their analysis, they selected appropriate historical data and performed Monte Carlo simulations. Half-hourly customer load data was provided to us by the Australian Energy Market Operator and incorporated into the Frontier analysis. Victorian half-hourly spot prices for the same period were sourced from the market operator's publicly available data.

The Monte Carlo simulations randomly generate a year of half-hourly observations. This process is repeated 500 times to generate a range of simulated years.¹⁸ Each simulated year is normalised to maintain load shape and the correlation between load and price. Each simulation is then scaled to half-hourly prices so that the time-weighted average price in each quarter is equal to the relevant quarterly ASX Energy base swap price for 2023–24, subtracting a contract premium.¹⁹ These simulations give a range of possible outcomes for demand and the relationship between price and demand for 2023–24.

price. Source: Australian Energy Market Commission, Spot and contract markets, accessed 19 December 2022, <https://www.aemc.gov.au/energy-system/electricity/electricity-market/spot-and-contract-markets>.

¹⁷ Frontier Economics, Wholesale electricity costs for 2023–24: A draft report for the Essential Services Commission, February 2023.

¹⁸ The random drawing of data is done from a pool of like days, where days are classified as either weekdays or weekends, from either Q1 (January to March), Q2 (April to June), Q3 (July to September) and Q4 (October to December).

¹⁹ The assumed contract premium is five per cent on the underlying prices.

Frontier then selects an efficient hedging position

With this range of possible demand conditions, Frontier then estimates the hedging position a prudent retailer would adopt. To estimate the cost of financial hedging, we asked Frontier to use 12-month trade-weighted hedging contract prices from ASX Energy (base swaps, peak swaps, and base \$300 caps). We are aware that there is a high volume of trade in swaps on the day that options are exercised. In response to stakeholder feedback we have asked Frontier to exclude the data from the day in question from the calculation of the trade-weighted average price.

An efficient contracting position was then estimated using Frontier Economics' STRIKE model. The model uses the ASX Energy contract prices and the demand conditions from the Monte Carlo simulations to determine the contracting positions that provide the lowest wholesale energy costs.

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

Our approach is consistent with the approach we used in the 2022–23 Victorian Default Offer, with the exception of the small change to exclude the data from the date that options contracts are exercised. The Monte-Carlo simulations used to estimate demand are again based on data from the most recent three years available (financial years 2019–20 to 2021–22).

We have factored network losses into our wholesale cost forecasts

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

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

Our draft decision for distribution loss factors is to use the short sub-transmission factor for the CitiPower, Jemena, and United Energy distribution zones and the weighted average of the short and long sub-transmission factors for the Powercor and AusNet zones.²⁰

²⁰ Australian Energy Market Operator, Distribution Loss Factors for the 2022–23 Financial Year, July 2022, p. 12. We will update network losses in our final decision paper to account for the most recent information.

In calculating the marginal loss factor, we take a simple average of the relevant regional reference node factor for each distribution zone.²¹ We remove some transmission nodes as they do not have any domestic or small business load. We combine these to calculate an adjustment factor which is applied to energy purchase costs, environmental costs, and ancillary charges.

Our approach is consistent with the approach we used in the 2022–23 Victorian Default Offer.

Stakeholder feedback on forecasting wholesale electricity costs

We received submissions from twelve retailers about wholesale electricity costs in response to our call for submissions on the 2023–24 Victorian Default Offer.²² We also received submissions about wholesale electricity costs from the Australian Energy Council, Consumer Action Law Centre and Energy Consumers Australia.

Stakeholders generally supported the continued use of our methodology. Some retailers submitted that recent market volatility has reduced smaller retailers' access to some hedging instruments and increased credit support requirements. Those retailers submitted that this would increase their costs.

Consumer representatives said that in an environment of rising household bills, we should continue to prioritise our objective to provide a simple, trusted and reasonably priced electricity option for people who are unable or unwilling to engage in the electricity market.

Use of ASX futures

The majority of the submissions that mentioned wholesale costs gave support for our continued use of ASX futures as the method to estimate wholesale electricity costs. Simply Energy, Momentum Energy, 1st Energy, Red Energy, Lumo Energy and Alinta Energy, as well as the Consumer Action Law Centre and Energy Consumers Australia all indicated they agree with us retaining our current methodology.²³ Many in this group also said that if we were to propose any widescale changes to our methodology, this should be signaled and consulted on well in advance of any changes being made.

²¹ Australian Energy Market Operator, Preliminary Marginal Loss Factors 2023–24 Financial Year, December 2022, p. 26–28.

²² 1st Energy, AGL, Alinta Energy, EnergyAustralia, Energy Locals Pty Ltd, GloBird Energy, Momentum Energy, Origin Energy, Powershop, Red Energy and Lumo Energy and Simply Energy made submissions about wholesale electricity costs.

²³ Simply Energy submission to Consultation Paper, January 2023, p. 2; Momentum Energy submission to Consultation Paper, January 2023, p. 1; 1st Energy submission to Consultation Paper, January 2023, p. 1; Red Energy and Lumo Energy submission to Consultation Paper, January 2023, p. 1; Alinta Energy submission to Consultation Paper, January 2023, p. 2; Consumer Action Law Centre submission to Consultation Paper, January 2023, p. 3; Energy Consumers Australia submission to Consultation Paper, January 2023, p. 1.

Some retailers, including GloBird Energy, Energy Locals and Powershop, as well as the Australian Energy Council said that ASX futures alone would not be sufficient to estimate wholesale costs, due to changing market conditions and reduced access to the futures market.

GloBird Energy pointed to the findings of the Australian Competition and Consumer Commission's recent report on the National Electricity Market²⁴, in particular findings that some smaller retailers have lost access to exchange traded contracts and must rely on other methods to manage their wholesale risk. GloBird Energy recognised the advantage in terms of transparency that using ASX futures brings, but suggested that a premium be added to our modelled outcome to reflect the additional risk management costs that retailers will face in 2023–24.²⁵

Powershop similarly believe that trade weighted futures by themselves will underestimate true wholesale costs, and suggest we include a risk premium in the 2023–24 Victorian Default Offer to reflect current market conditions.²⁶

Energy Locals said that while they generally support our proposal to continue using ASX futures, they are concerned about the additional capital requirements smaller retailers are facing due to increased prudential requirements and margin calls. They suggest that these costs should be included in the Victorian Default Offer calculation because they reflect the reality of market participation in 2023.²⁷ EnergyAustralia also shared the view that increased provisions for margining requirements should be reflected in the 2023–24 Victorian Default Offer.²⁸

The Australian Energy Council supported our proposal to continue using ASX futures for the 2023–24 Victorian Default Offer, but suggest we include an additional amount for updated retailer margining costs. Like several retailers, they reference the findings of the Australian Competition and Consumer Council's recent report on the National Electricity Market,²⁹ including the importance of regulated prices accurately reflecting market hedging costs. They draw particular attention to the impact of the market shifting towards using more over-the-counter contracts, as well as the increased costs of margining and collateral.³⁰

²⁴ Australian Competition and Consumer Commission, Inquiry into the National Electricity Market, November 2022.

²⁵ GloBird Energy submission to Consultation Paper, January 2023, p. 1-2.

²⁶ Powershop submission to Consultation Paper, January 2023, p. 2.

²⁷ Energy Locals Pty Ltd submission to Consultation Paper, January 2023, p. 1.

²⁸ EnergyAustralia submission to Consultation Paper, January 2023, p. 6.

²⁹ Australian Competition and Consumer Commission, Inquiry into the National Electricity Market, November 2022.

³⁰ Australian Energy Council submission to Consultation Paper, January 2023, p. 2.

In response to these suggestions, and with the current issues with access to the wholesale market in mind, we have investigated the reports of changes to how retailers are engaging with the wholesale market.

We used our information gathering powers in July 2022 to collect information from retailers about how they hedge and manage wholesale risk. We were able to examine retailers' use of the over-the-counter market and found that only a small proportion of Victorian customers (less than 1 per cent) receive their electricity from a retailer who has large exposure to this market and no access to ASX futures. We continue to monitor the conditions of the wholesale market and recognise that some retailers may no longer have the ability to use ASX futures as they have in the past. However, the information currently available to us suggests that over-the-counter contracts continue to make up only a small share of Victorian retailers' hedging contracts.

In recent years, ASX futures contract prices and over-the-counter prices have tended to be very similar. This can be observed in the ACCC's report, which shows that prices for ASX futures contracts and over-the-counter contracts in Victoria were quite similar throughout 2021 and Q1 2022, diverged in Q2 2022, before again becoming quite similar by Q3 2022.³¹ Given this, and the lack of publicly available data on over-the-counter contract prices, we retain the view that using ASX futures contracts in the 2023–24 Victorian Default Offer reflects the efficient costs of purchasing wholesale electricity. Also, while the volume of over-the counter contracts bought by retailers increased in the first half 2022, by August 2022 over the counter trade volumes were back to earlier levels.³²

Additionally, we have analysed the scale of the increased credit support requirements retailers may be likely to face in 2023–24. Our view is that any increase in costs retailers may face related to credit support requirements is relatively small. We note that the Queensland Competition Authority and its consultant recently came to similar conclusions.³³

We also note that the interest costs of holding working capital are the main cost associated with increased credit support requirements. Interest payments are covered by the retail operating margin. As wholesale costs increase, so too will the dollar value of the retail operating margin that retailers receive. Our analysis shows that the increase in the dollar value of the retail operating margin provides an adequate amount for any increased credit support requirements.

³¹ Australian Competition and Consumer Commission, Inquiry into the National Electricity Market, November 2022, p. 59.

³² Australian Competition and Consumer Commission, Inquiry into the National Electricity Market, November 2022, p. 54.

³³ Queensland Competition Authority interim consultation paper: Regulated retail electricity prices for 2023–24 Interim Consultation Paper, December 2022, p. 9.

AGL supported our proposal to continue using ASX futures, but highlighted that as options contracts are becoming more popular, we should consider our treatment of options contracts in our methodology.

AGL proposed two ways that we could appropriately account for options in our calculation of the wholesale energy costs for 2023–24:

- remove the data for the exercised options from the book-build of the trade weighted forward contract prices (this would be those exercised in November 2022)
- retain the options data in the trade weighted average calculation but then account for the premiums paid to enable these option volumes and values to be struck and exercised.³⁴

We agree that the volume of trade in swaps on the day that options are exercised leads to this date having a higher effect on the trade-weighted approach to determining contract prices. Frontier's STRIKE model does not assume retailers use options contracts. If we include contracts bought using options in our trade weighted average of contract prices, it could bias our wholesale cost benchmark. For this reason, we propose to remove the day that options are exercised from the calculation of the trade-weighted contract prices for our wholesale cost forecasts.

For the 2023–24 Victorian Default Offer calculations, the date with this high volume of trade is 21 November 2022: on this day options for Q3 and Q4 2023 were exercised.

Our approach to wholesale electricity costs accounts for managing price volatility

Origin Energy were generally supportive about retaining our methodology, but did suggest we carry out a retrospective analysis to assess how well our modelling captures price volatility. In particular, they suggested comparing actual wholesale electricity costs in 2022–23 against the modelled distribution that was used in the 2022–23 Victorian Default Offer.³⁵

The Australian Energy Council also pointed to the recent trends and high volatility in the wholesale market, and suggested we investigate the adequacy of our methodology for calculating the volatility allowance that forms part of the Victorian Default Offer cost stack.³⁶

Our approach to estimating wholesale electricity costs does account for changes in market conditions. Through Frontier Economics' modelling, our estimate for wholesale electricity costs in 2023–24 now includes the volatile prices that occurred in 2022. Similarly, the estimate also

³⁴ AGL submission to Consultation Paper, January 2023, p. 1-2.

³⁵ Origin Energy submission to Consultation Paper, January 2023, p. 2.

³⁶ Australian Energy Council submission to Consultation Paper, January 2023, p. 2.

accounts for the fact that both wholesale contract prices for 2023–24 and expectations of future spot prices for 2023–24 are now higher than they were at the equivalent time when estimating the wholesale electricity cost for 2022–23.

Frontier’s approach to estimating wholesale electricity costs has been designed to base estimates of future spot price volatility and future load volatility entirely on recent historical volatility. This is done to ensure that the approach is as transparent as possible and that the approach can be replicated by interested stakeholders.

However, this does not mean that Frontier’s approach to estimating wholesale electricity costs leaves retailers exposed to unexpected price volatility. Frontier’s approach is based on a hedging position that provides retailers with as little risk as possible. This implies having a total contract position that more or less matches peak demand. If retailers adopted a contract position like this, they would have been substantially protected from higher than expected prices for financial year 2022-23.³⁷

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

GloBird Energy submitted that there has been a lack of consistency in how we set the end date of the 12-month window used to collect ASX energy prices. While they note the importance of using the latest data in our final decision, they highlight the importance of transparency and consistency in our methodology, and suggest that the end date of the 12-month average trade weighted average price window be fixed on 30 April of the relevant year.³⁸

We agree that fixing the end date for the 12-month window will improve transparency and consistency. We propose the last Friday of April as the date for taking our final reading of ASX Energy contracts prices for use in our wholesale cost benchmark for the 2023-24 Victorian Default Offer and future Victorian Default Offer reviews.

Network costs

- Our draft decision is to keep using a cost pass through approach for network costs.
- For our draft decision on these network costs, we have used the indicative network tariffs from the annual pricing models of Victorian network businesses for the 2023–24 financial year. These indicative network tariffs have been escalated by the consumer price index.

³⁷ Frontier Economics, Wholesale electricity costs for 2023–24: A draft report for the Essential Services Commission, February 2023, p. 46.

³⁸ GloBird Energy submission to Consultation Paper, January 2023, p. 2.

- The approved 2023–24 tariffs are not yet available. We will update the network tariffs in our final decision once the Australian Energy Regulator approves network tariffs.
- Based on the benchmarks we adopt for the Victorian Default Offer, network costs represent about 32 per cent of the average domestic bill (averaged across the five distribution zones).

Network costs represent the costs of building, operating and expanding electricity transmission and distribution networks. There are five electricity distribution networks operating in five separate zones across Victoria, each with their own maintenance needs and growth rates.

The charges for each network are approved by the Australian Energy Regulator annually and are paid by electricity retailers for access to transmission and distribution services. We are required to have regard to network costs in estimating efficient costs.³⁹

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

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

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

We propose to keep our approach for calculating network costs. This is a cost pass through approach to establishing a benchmark for network costs, using the 2023–24 network tariffs approved by the Australian Energy Regulator for each distribution zone (Appendix C). This approach has been supported by stakeholders during our previous Victorian Default Offer reviews.⁴⁰

Network costs are generally structured in one of two ways:

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

³⁹ Clauses 12(4)(b) of the pricing order.

⁴⁰ Essential Services Commission, 1 January 2022 Victorian Default Offer: Final decision, November 2021, p. 18; Essential Services Commission, 1 January 2021 Victorian Default Offer: Final decision, November 2020, p. 18; Essential Services Commission, 1 January 2020 Victorian Default Offer: Final decision, November 2019, p. 33; Essential Services Commission, 1 July 2019 Victorian Default Offer: Final decision, May 2019, p. 39.

- a daily supply charge and peak usage and off-peak usage charge (two-period time of use network tariffs).⁴¹

We also include metering charges for each distribution zone, and a controlled load option for domestic customers where applicable. We estimate the metering charges by calculating a customer weighted average of the different metering costs in each distribution zone.

For our draft decision on these network costs, we have used the indicative tariffs in the annual pricing models of Victorian network business. Network tariffs for 2023–24 are scheduled to be finalised by the Australian Energy Regulator in early May 2023. We intend to update the Victorian Default Offer to reflect the finalised tariffs in our final decision.

Overall, network costs for the domestic Victorian Default Offer bill are higher for our draft decision than they were in the 2022–23 Victorian Default Offer. We are adjusting the nominal value of these tariffs for increases in the consumer price index. In escalating these tariffs, the network costs remain constant in real terms. This reflects the Australian Energy Regulator’s practice of adjusting networks’ tariffs for changes in inflation. On the basis of Victorian Networks’ revenue determinations, and the current rate of inflation, we expect network tariffs for 2023–24 to be higher than those for 2022–23.

Since approved tariffs for 2023–24 are not available at the time of the draft decision, using the indicative tariffs and adjusting for inflation will be useful in the interim. As noted before, we plan to use the updated tariffs for the final decision.

Given current high rates of inflation we expect that network tariffs will be significantly higher than the current tariffs. Adjusting the Australian Energy Regulator’s indicative network tariffs for 2023–24 for inflation will ensure that our draft decision cost estimates are closer to our final decision estimates.

We have considered stakeholder submissions on network costs

We received three submissions on our approach to network costs.

Alinta Energy raised the risk of potential delays in finalising the Victorian Default Offer due to the timing of network tariff regulation decisions. These decisions are usually processed in April, three months prior to their effective date at the beginning of the financial year in July. Alinta notes that this issue is outside of the commission’s control.⁴²

⁴¹ We introduced a two-period time of use tariff Victorian Default Offer when we amended the 2021 Victorian Default Offer price determination in July 2021.

⁴² Alinta Energy submission to Consultation Paper, January 2023, p. 3.

Origin Energy supported our cost pass-through approach to network costs. They suggested that in case of any timing issues, we ought to use the network tariffs submitted by network businesses to the Australian Energy Regulator. Origin Energy then submitted that if there are any differences between the proposed and approved network tariffs, then the commission should apply a true-up.⁴³

1st Energy submitted that the Default Offer should include network costs approved by the Australian Energy Regulator.⁴⁴

We will remain in contact with the Australian Energy Regulator to help ensure the smooth implementation of network tariffs into the Victorian Default Offer. We also note that in this draft decision we have used Victorian network's indicative 2023—24 tariffs adjusted for inflation.

Environmental costs

- Our draft decision is to maintain our current approach for estimating costs for the Small-scale Renewable Energy Scheme, Large-scale Renewable Energy Target, Victorian Energy Upgrades program and the minimum feed-in tariff.
- Environmental costs represent about seven per cent of the average domestic Default Offer bill (averaged across the five distribution zones).
- Our draft decision means the dollar value of environmental costs in the cost stack has gone down, decreasing by four per cent compared to the amount in the 2022–23 Victorian Default Offer. This is mainly driven by a decrease in small-scale technology percentage.

In line with the pricing order, we are required to have regard to environmental costs when reviewing and setting the Default Offer.⁴⁵ Environmental costs are incurred by Victorian electricity retailers due to the regulatory requirements they must comply with. Electricity retailers have a legal obligation to meet these requirements and incur costs as a result. As these costs are unavoidable, including environmental costs helps the Victorian Default Offer prices reflect the efficient costs of the sale of electricity by a retailer.

The four environmental costs faced by Victorian electricity retailers relate to the following programs:

- Large-scale Renewable Energy Target

⁴³ Origin Energy submission to Consultation Paper, January 2023, p. 5.

⁴⁴ 1st Energy submission to Consultation Paper, January 2023, p. 1.

⁴⁵ Clause 12(4)(c) of the pricing order.

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

Our draft decision maintains our approach to environmental costs

Our draft decision has included benchmarks for environmental costs based on public sources. This is the same approach adopted in previous reviews.

The amount included in the cost stacks means the dollar value will go down by four per cent (\$133 per customer) compared to the amount in the 2022–23 Victorian Default Offer.

Our draft decision on how to calculate environmental costs as components of the Default Offer is as follows:

- Large-scale Renewable Energy Target – the 2023 renewable power percentage multiplied by the financial year 2023–24 forward market price for large-scale generation certificates. Then a true-up is added to account for the difference in renewable power percentage used in our previous decision and the actual midpoint percentage for 2022–23.
- Small-scale Renewable Energy Scheme – the mid-point between the 2023 binding and the 2024 non-binding small-scale technology percentage is multiplied by the clearing house price (\$40 excluding GST). Then a true-up is added to account for the difference between the binding small-scale technology percentages for 2022 and 2023.⁴⁶
- Victorian Energy Upgrades – the 12-month trade-weighted average spot price of Victorian energy efficiency certificates (VEEC) is multiplied by the 2023 greenhouse gas reduction rate.⁴⁷
- The above costs are multiplied by the network loss factors.
- The social cost of carbon applied to the minimum feed-in tariff – total renewable exports in the most recent financial year is multiplied by the social cost of carbon (2.5 cents per kWh for 2023–24).⁴⁸ The resulting figure is divided by the average number of domestic and small business customers in the same period.

Our final decision will include an update to the data used in this draft decision. Including a more recent trade-weighted average spot price for Victorian energy efficiency certificates, a more recent

⁴⁶ STC clearing house price is fixed at \$40 excluding GST. Clean Energy Regulator, <http://www.cleanenergyregulator.gov.au/OSR/REC/STC-clearing-house>, accessed 16 January 2023.

⁴⁷ From 10 January 2022 to 9 January 2023. Greenhouse gas reduction rate for electricity for 2023 is 0.16307, Essential Services Commission, <https://www.esc.vic.gov.au/victorian-energy-upgrades-program/participating-veu-program/energy-retailers-veu-program#toc--determining-liability>, accessed 16 January 2023.

⁴⁸ From 1 July 2021 to 30 June 2022.

forward market price for large-scale generation certificates, more recent renewable export data and customer numbers for the social cost of carbon.

Stakeholders support the inclusion of environmental costs

Overall the submissions we received in response to our consultation paper supported environmental costs being included and for our approach to prior Victorian Default Offers to continue for this decision.⁴⁹

Energy retailers are required to comply with federal and state environmental programs. Retailers incur costs as a result. Our role is to determine the cost that an efficient retailer would need to recover from their customers for providing energy. Environmental costs are included in the Default Offer because, as government requirements, they are unavoidable. Our draft decision shows the environmental cost will go down by four per cent (\$133 per customer) compared to the amount in the 2022–23 Victorian Default Offer.

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

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

Under the Large-scale Renewable Energy Target, eligible renewable power stations create largescale generation certificates for every megawatt hour of power they generate. Electricity retailers buy certificates to meet their legally binding renewable energy obligations. Electricity retailers then surrender the certificates to the Clean Energy Regulator based on the renewable power percentage the regulator sets each year.

Our draft decision is to keep our approach to calculating the cost of complying with the Large-scale Renewable Energy Target the same as in previous decisions. Our approach to calculating Large-scale Renewable Energy Target costs using future market prices for certificates provides a transparent estimate of the efficient costs of complying with the program.

Our approach to estimate the per megawatt benchmark cost for the Large-scale Renewable Energy target is, to start with the 2023 renewable power percentage calculated by the Clean

⁴⁹ Ronald Heard submission to Consultation Paper, December 2022, p. 1; Alinta Energy submission to Consultation Paper, January 2023, p. 3; Origin Energy submission to Consultation Paper, January 2023, p. 5.

Energy Regulator.⁵⁰ We then multiply the renewable power percentage by the average future market price for 2023–24 largescale generation certificates. We then include a true-up to account for the difference between the renewable power percentage used in our previous decision and the most recent information available on the renewable power percentage.⁵¹ We have included a true-up adjustment as retailers have no control over the renewable power percentage.

In our final decision for the 2022–23 Victorian Default Offer we included a true-up to account for the difference between the 1 January 2022 Default Offer determination and the determination to apply from 1 July 2022. We have continued our approach to include a true-up between decisions, however we now use a midpoint renewable power percentage.

However, as the renewable power percentage is set at the beginning of each calendar year, and we now set the Default Offer for financial years, the true up in this decision is calculated slightly differently. For this draft decision we have used the 2023 renewable power percentage (18.96 per cent), for the 2022–23 Default Offer we used the 2022 renewable power percentage (18.64 per cent).

Our final decision will also include the true-up to account for the difference in renewable power percentage between 2022 and the midpoint for 2022 and 2023, as well as more recent trade-weighted prices for largescale generation certificate prices.

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

The Small-scale Renewable Energy Scheme places an obligation on retailers to purchase small-scale technology certificates. Each year the Clean Energy Regulator sets a binding small-scale technology percentage, and non-binding small-scale technology percentages for future years. This sets the amount of small-scale technology certificates retailers must buy. Energy retailers must then surrender small-scale technology certificates, based on the small-scale technology percentage, to meet their obligation for that year.

Our draft decision is to use the same approach to calculating the cost of the small-scale renewable energy scheme as was used in previous Victorian Default Offer decisions. We use the mid-point of the 2023 binding and 2024 non-binding small-scale technology percentages, multiplied by the STC

⁵⁰ Clean Energy Regulator has set the renewable power percentage for 2023 at 18.96 per cent. Clean Energy Regulator <https://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-renewable-power-percentage#Calculating-the-renewable-power-percentage>, accessed 6 February 2023.

⁵¹ Clean Energy Regulator set the renewable power percentage for 2022 at 18.64 per cent and 18.96 per cent for 2023, the midpoint is 18.80 per cent which results in a true-up of \$0.07 per customer per year. Clean Energy Regulator <https://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-renewable-power-percentage#Calculating-the-renewable-power-percentage>, accessed 6 February 2023.

clearing house price (\$40), then a true-up is applied for the difference between the actual small-scale technology percentage for 2023.⁵² The true-up accounts for the difference between small-scale technology percentages between Default Offer decisions.

The 2023 small-scale technology binding percentage is 16.29 per cent, and the 2024 small-scale technology non-binding percentage is 17.99 per cent, the mid-point percentage is 17.14 per cent.⁵³

In our final decision for the 2022–23 Victorian Default Offer, we used the midpoint of the binding percentage for 2022 and the non-binding percentage for 2023. Since we made our final decision for the 2022–23 Default Offer the Clean Energy Regulator has set the binding percentage for 2023, which is 6.05 per cent lower than the non-binding percentage for the same year.

This means the mid-point small-scale technology percentage used in the 2022–23 Default Offer was approximately three percentage points higher than the actual mid-point. This has resulted in the true-up in this draft decision being negative leading to a reduction in the cost of compliance with the Small-scale Renewable Energy Scheme for 2023–24.

Given the small-scale technology percentages and small-scale technology certificate prices are known for 2023–24, in the absence of any stakeholder submissions or new evidence, there will be no change in our final decision for Small-scale Renewable Energy costs.

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

The Victorian Energy Upgrades program is Australia's largest energy efficiency program and a key mechanism in the state's climate change framework. The program aims to deliver greenhouse gas emission reductions for the state, while helping Victorians reduce their energy costs. Under the Victorian Energy Upgrades program, accredited persons carry out upgrade activities by installing energy-efficient products to generate Victorian energy efficiency certificates. Energy retailers must acquire and surrender these certificates to meet annual targets set in Victorian legislation.

Our draft decision is to keep our approach to calculating the cost the Victorian Energy Upgrades program. We use the most recent 12-months' trade-weighted average spot price for Victorian energy efficiency certificates multiplied by the 2023 greenhouse gas reduction rate for electricity.⁵⁴

⁵² Small-scale renewable energy system owners and registered agents have the option to sell small-scale technology certificates (STCs) through the open market for an uncapped price, or through the STC clearing house at a fixed price of \$40 (ex GST). Clean Energy Regulator, <https://www.cleanenergyregulator.gov.au/OSR/REC/STC-clearing-house>, accessed 6 February 2023.

⁵³ Clean Energy Regulator, <https://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-small-scale-technology-percentage#About-the-smallscale-technology-percentage>, accessed 6 February 2023.

⁵⁴ From 10 January 2022 to 9 January 2023. Greenhouse gas reduction rate for electricity for 2023 is 0.16307, Essential Services Commission, <https://www.esc.vic.gov.au/victorian-energy-upgrades-program/participating-veu-program/energy-retailers-veu-program#toc--determining-liability>, accessed 16 January 2023.

Using an average certificate price of \$69 excluding GST, multiplied by the 2023 greenhouse gas reduction rate of 0.16307 results in a Victorian Energy Upgrades costs of \$11.25 per megawatt hour. This is a decrease from the Victorian Energy Upgrades cost in the 2022–23 Victorian Default Offer of 61 cents from \$11.86.

For our final decision we will update the Victorian energy efficiency certificate prices and volume of trades for the most recent 12-month period.

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

The minimum feed-in tariff is the rate that energy retailers must pay solar customers for electricity exported to the grid. The feed-in tariff includes the social cost of carbon which is the value of lowering carbon emissions when energy is sourced from small-scale renewable generators. The Victorian Government set the social cost of carbon at 2.5 cents per kWh.⁵⁵

When small-scale renewable generators export energy into the grid, retailers must pay them the social cost of carbon on top of the wholesale price of electricity. This is the cost of the minimum feed-in tariff that we account for in the Victorian Default Offer.

Our draft decision is to maintain our current approach to calculating the cost associated with the minimum feed-in tariff. To estimate the cost to retailers, we took the total renewable exports for the 2021-22 financial year and multiply this by the social cost of carbon. The resulting figure was then divided by the total average number of domestic and small business customers over the same period.

For our final decision we will use updated total renewable export data and domestic and small business customer data for the most recent 12-month period.

Retail operating costs

- Our draft decision is to set a retail operating cost benchmark based on the customer weighted average of retailers' actual retail operating costs. This is a change from the approach used in our final decision on the 2022–23 Victorian Default Offer.
- Retail operating costs represent about seven per cent of costs in the average domestic bill (averaged across the five distribution zones).

⁵⁵ Victorian Government 2017, Victoria Government Gazette No. S 36, Tuesday 21 February 2017, Order specifying a methodology and factors for the determination of the avoided social cost of carbon. Essential Services Commission calculation, Minimum electricity feed-in tariffs to apply from 1 July 2023 final decision, February 2023 page 63.

- The retail operating costs in our draft decision are about nine per cent lower than the amount included in our 2022–23 Victorian Default Offer determination.

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

- billing and revenue collection systems
- information technology systems
- call centre costs
- corporate overheads
- energy trading costs
- provision for bad and doubtful debts
- regulatory compliance costs.

The pricing order requires we have regard to retail operating costs as an element in developing the efficient costs of the sale of electricity by a retailer.⁵⁶

In our consultation paper, we invited stakeholders to submit their views on alternative approaches to setting the retail operating cost benchmark.

During previous reviews, we have used a benchmark set by the Independent Competition and Regulatory Commission (ICRC) for retail electricity prices in the Australian Capital Territory.⁵⁷ We adjusted this benchmark by the consumer price index each year and added costs to reflect Victoria-specific operating costs.

In turn, the Independent Competition and Regulatory Commission set their benchmark based on the 2013 review of regulated retail prices for electricity by the Independent Pricing and Regulatory Tribunal (IPART).⁵⁸

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

We investigated different approaches to setting the retail operating cost benchmark using the principles outlined in our consultation paper. Our draft decision is to use a benchmark based on retailers' actual costs.

The benchmark for retail operating costs we have used in previous decisions is still within the range of Victorian retailers' actual costs. However, if we continue our approach of adjusting this

⁵⁶ Clause 12(4)(d) of the pricing order.

⁵⁷ Independent Competition and Regulatory Commission, Standing offer prices for the supply of electricity to small customers from 1 July 2017, Final report, June 2017.

⁵⁸ Independent Pricing And Regulatory Tribunal, Review of retail prices for electricity from 1 July 2013 to 30 June 2016, Final report, June 2013.

benchmark, we would be estimating retail operating costs based on a benchmark from ten years ago. There have been many changes in the retail electricity market over this period.

Also, after collecting retailers' cost data for several years, we now have greater confidence in the appropriateness of using the cost data to set a retail operating cost benchmark. The range, median and customer weighted average of retailers' retail operating costs have been relatively stable over the last four years. So we have more confidence in the data now than we did in earlier Victorian Default Offer reviews.

The cost data we have collected shows retailers' retail operating costs are decreasing. Continuing to increase the 2022–23 retail operating cost benchmark in line with changes in the consumer price index, when we know actual costs have been decreasing may lead to a divergence between retailers' efficient costs and our benchmark. This suggests that using a benchmark based on actual costs would be more efficient and accurate.

Basing our benchmark on the customer weighted average of retailers' actual costs will ensure our benchmark allows retailers can recover the efficient costs of the sale of electricity by a retailer. The benchmark will reflect the most up to date cost information available. Both increases in costs and productivity improvements will be accounted for.

For these reasons, we consider that using the cost data to set the retail operating cost benchmark would best meet the objectives of the Victorian Default Offer and the Essential Services Commission Act.

The benchmark is based on the customer weighted average

For our draft decision we have used data we gathered from retailers for the 2021–22 financial year to determine the benchmark. We propose to set the benchmark using the customer weighted average of retailers' reported retail operating cost data. Since the latest available data is from 2020–21, we have adjusted it for inflation so it is constant in real terms. Adjusting the new benchmark for inflation results in a retail operating cost benchmark of \$134.54 excluding GST. This is lower than the benchmark amount included in the Victorian Default Offer 2022–23 of \$146.35. It is also lower than the benchmark amount would be for this decision if we continued to use the benchmark set by the Independent Pricing and Regulatory Tribunal (\$153.90 excluding GST).

For our final decision, we intend to use retailer cost data from financial year 2021–22 and adjust this for inflation for the three quarters from June 2022 to March 2023 once that data becomes available.

We have used the customer weighted average to give larger retailers greater weight in determining the benchmark. The Victorian Default Offer tariffs are intended to reflect the efficient costs of the sale of electricity. Based on the data we collect there are economies of scale in retailing electricity,

and so we consider that the customer weighted average is, for our purposes, a better benchmark for retail operating costs than other measures of statistical central location (such as the median).

Another advantage of using retailers' actual costs is that in future years we will require fewer adjustments to the benchmark. Where new regulatory obligations are introduced, these will be reflected in the cost data used to set the benchmark. Similarly, to the extent the industry becomes more efficient over time, those productivity gains will be reflected in the benchmark. For these reasons we have not included additional amounts for Victoria-specific costs, 5-minute settlements costs, consumer data right costs or a productivity factor.

Our approach meets the principles outlined in our consultation paper

We consider that using the customer weighted average of retailers' actual costs best meets the objectives of the Victorian Default Offer. It is a simple and reasonable benchmark that reflects the efficient costs of the sale of electricity by a retailer. A benchmark based on the customer weighted average supports:

Efficiency: Using the customer weighted average of retailers' actual costs will create a benchmark that retailers can strive to beat which cannot be influenced by individual retailers. The customer weighted average will also reflect economies of scale better than other measures of central location.

Accuracy: As it is based on retailer cost data, using the customer weighted average of retailers' actual costs will be an accurate representation of retailers' efficient costs. It uses the most recently available cost data for retailers in Victoria.

Transparency: The data underlying the calculation of the customer weighted average of retailers' retail operating costs is confidential. However, stakeholders can sense check the information using information from publicly listed retailers and the ACCC.

Simplicity: The customer weighted average is a relatively simple concept to understand and calculate.

Stability: The customer weighted average will also be relatively stable. While some individual retailers' costs may fluctuate significantly from year to year, the customer weighted average is much more stable.

Retailers' actual costs have decreased

We have gathered retailers' actual cost data using our data gathering powers under section 36 of the *Essential Services Commission Act 2001*. In previous decisions, we have used this actual cost data to cross check the inflation adjusted benchmark. Our analysis indicates that our previous retail operating cost benchmark was higher than the median and customer weighted average of retailer's actual cost. We also noted a trend of decreasing customer weighted average costs over the years.

Continuing to inflate our previous benchmark for inflation may result in a loss of alignment with the operating costs of an efficient retailer.

Publicly available cost data suggests retail operating costs are decreasing

We compared our evidence to the information from the publicly available reports of three retailers – AGL, Origin Energy and Snowy Hydro (Red Energy/Lumo Energy). We cannot directly use this information to set the retail operating cost benchmark as these retailers operate outside Victoria as well. Alongside this, their public accounts may have some differences in what are included in their operating costs, compared to the costs we would expect in a retail operating cost benchmark. Nonetheless it provides a good cross check of the cost data we collect from retailers. The statements and estimates published by retailers are based on independently audited information and are subject to obligations under the Corporations Act 2001 to be reasonable and supportable.

AGL and Origin Energy reported that operating costs decreased between financial year 2020–21 and financial year 2021–22.⁵⁹ Snowy Hydro's annual report for financial year 2021–22 does not report the operating cost per customer. Their annual report has consolidated the retail and wholesale business which makes it difficult to calculate any per customer costs. However, their report notes that they had significantly lower bad and doubtful debt expenses as compared to 2021 and that their labour costs were reduced as well due to lower headcount in a tight labour market.⁶⁰

While AGL, Origin Energy and Red Energy/Lumo Energy are only three of the many retailers which operate in Victoria, together they serve more than 50 per cent of Victorian customers. Origin Energy and AGL also account for a large share of Victorian Default Offer customers.⁶¹

The Australian Competition and Consumer Commission reports costs are decreasing

The Australian Competition and Consumer Commission (ACCC) released their latest Inquiry into the National Electricity Market (NEM) report. This report noted that increased competition in the National Electricity Market has delivered benefits to customers in the form of a decline in retail costs. National Electricity Market-wide retail costs in 2021–22 declined by 4 per cent relative to 2020–21.⁶² Supplementary documents provided along with the report showed the decline of operating costs in Victoria. The cost to serve in Victoria reduced from \$93 to \$80 between 2018 and 2022.

⁵⁹ AGL, Annual report, 19 August 2022, p. 38. Origin Energy, Annual report, 18 August 2022, p. 32.

⁶⁰ Snowy Hydro, Annual report, 31 August 2022, p. 47.

⁶¹ The majority of standing offer customers are customers with AGL, EnergyAustralia and Origin Energy.

⁶² Australian Competition and Consumer Commission, Inquiry into the National Electricity Market November 2022 report, 23 November 2022, p. 3.

There are some differences between the ACCC's cost to serve amount and our benchmark. The ACCC's cost to serve amounts do not include all retail operating cost items. Also, the ACCC's cost stack is based on data from 15 retailers that operate in the National Electricity Market. We collected data from 16 Victorian retailers in 2023.

Stakeholders' views about how to set the retail cost benchmark were mixed

We received 20 submissions on our approach to retail operating costs.

Largely, retailers were of the view that we should keep the benchmark set by the Independent Competition and Regulatory Commission and adjust it for consumer price inflation.⁶³ In general this was because they were of the view that this approach was transparent, simple and stable. But one retailer suggested our benchmark be based on Victorian retailers' cost data.⁶⁴

Basing our retail operating cost benchmark on retailers' cost data is an approach that stakeholders, especially retailers, have advocated for in past reviews.⁶⁵ Recently, EnergyAustralia also advocated for greater use of retailer cost data in its submission to the review of the Victorian Default Offer Order in Council.⁶⁶

Consumers and consumer advocates supported the view that the approach to the retail operating benchmark should be changed and any new approach should include a productivity factor.⁶⁷

Consumer Action Law Centre supported using our information gathering powers under the Essential Services Commission Act to collect retailers' actual cost data.⁶⁸ Energy Consumers

⁶³ Energy Locals Pty Ltd submission to Consultation Paper, January 2023, p. 2; Simply Energy submission to Consultation Paper, January 2023, p. 2-4; GloBird Energy submission to Consultation Paper, January 2023, p. 3-4; Momentum Energy submission to Consultation Paper, January 2023, p. 2-3; Australian Energy Council submission to Consultation Paper, January 2023, p. 4; Red Energy and Lumo Energy submission to Consultation Paper, January 2023, p. 1-2; Powershop submission to Consultation Paper, January 2023, p. 5; Alinta Energy submission to Consultation Paper, January 2023, p. 2; AGL submission to Consultation Paper, January 2023, p. 3; Origin Energy submission to Consultation Paper, January 2023, p. 3-5; EnergyAustralia submission to Consultation Paper, January 2023, p. 1-6.

⁶⁴ 1st Energy submission to Consultation Paper, January 2023, p. 2.

⁶⁵ Onsite Energy Solutions submission to staff working paper, Victorian Default Offer to apply from 1 July 2019, January 2019, p. 4; Origin Energy submission to staff working paper, Victorian Default Offer to apply from 1 July 2019, January 2019, pp. 6-7; Tango submission to draft decision, Victorian Default Offer to apply from 1 January 2020, October 2019, p. 5; AGL submission to draft decision, Victorian Default Offer to apply from 1 January 2020, October 2019, p. 5; 1st Energy submission to draft decision, Victorian Default Offer to apply from 1 January 2020, October 2019, p. 2-3; AGL submission to draft decision, Victorian Default Offer to apply from 1 January 2022, October 2021, p. 4; AGL submission to Consultation Paper, Victorian Default Offer 2022-23, February 2022, p. 3.

⁶⁶ EnergyAustralia submission to Review of Victorian Default Offer Order In Council, April 2022, p. 1-5.

⁶⁷ Victorian Council of Social Services submission to Consultation Paper, January 2023, p. 2; Consumer Action Law Centre submission to Consultation Paper, January 2023, p. 4-6; Energy Consumers Australia submission to Consultation Paper, January 2023, p. 2; Ray Stephens submission to Consultation Paper, December 2022, p. 2; Michael Tierney submission to Consultation Paper, January 2023, p. 1; Candice Miles submission to Consultation Paper, December 2022, p. 1; Errol Muir submission to Consultation Paper, December 2022, p. 1.

⁶⁸ Consumer Action Law Centre submission to Consultation Paper, January 2023, p. 4-6.

Australia noted that the benchmark should not increase with inflation while actual costs are decreasing.⁶⁹

We propose to use the customer weighted average of retailers' operating costs

As discussed earlier in this section, we consider that using a benchmark based on the actual cost data we collect from retailers will best meet the principles we proposed for choosing an approach to assessing retail operating costs.

Although the benchmark for retail operating costs we have used in previous decisions is still within the range of Victorian retailers' actual costs it is now ten years old. Also, after collecting retailers' cost data from financial year 2019, we now have greater confidence in the appropriateness of using the cost data to set a retail operating cost benchmark. Using a benchmark based on retailers' actual costs will also deal with the two most frequent suggestions for improvement to the past approach. It will automatically reflect retailers' regulatory obligations and also productivity improvements.

Temporary bad debt adjustment is not required

The Australian Energy Council along with Powershop, Simply Energy and EnergyAustralia noted that retailers expected higher costs in 2023–24 due to higher bad debt provisions.⁷⁰

Evidence from the publicly listed retailers, suggests a temporary adjustment for bad and doubtful debts is not required. Bad and doubtful debt expenses for all three publicly listed retailers decreased between financial year 2020–21 and financial year 2021–22.⁷¹ We have received no new information which changes our views set out in previous decision papers. However, we will continue to monitor market conditions.

We also note that using retailers' actual costs to set the benchmark efficient costs, ensures that retailers are compensated for their efficient costs. If there are any increases in the costs of bad and doubtful debt expenses in the future, these increases would be accounted for in retailers' cost data and so also be included in our benchmark.

⁶⁹ Energy Consumers Australia submission to Consultation Paper, January 2023, p. 2.

⁷⁰ Simply Energy submission to Consultation Paper, January 2023, p. 3-4; Australian Energy Council submission to Consultation Paper, January 2023, p. 4; Powershop submission to Consultation Paper, January 2023, p. 5; EnergyAustralia submission to Consultation Paper, January 2023, p. 5-6.

⁷¹ Snowy Hydro, Annual report, 31 August 2022, p. 63; Origin Energy, Annual report, 18 August 2022, p. 32; AGL, Annual report, 19 August 2022, p. 38.

The customer weighted average will account for retailers' regulatory costs

The Consumer Data Right is a reform enacted by the Australian Government designed to allow consumers greater access and control over their data, to improve consumers' ability to compare and switch between products and services.⁷² This reform applied to tier 1 electricity retailers from November 2022 and will apply to large electricity retailers with over 10,000 customers from November 2023. During the 2022–23 review, we found evidence that suggested the ongoing costs of complying with the Consumer Data Right for the first tranche of retailers were very low.⁷³

With the Consumer Data Right applying to more electricity retailers in 2023–24, we invited stakeholder views on the ongoing costs associated with the Consumer Data Right reforms.

We received 10 submissions on our approach to Consumer Data Right costs.

Retailers believed that the Consumer Data Right has significant implementation and ongoing operational costs for compliance. Retailers supported the inclusion of an adjustment for this reform in the Victorian Default Offer.⁷⁴ Some retailers provided us with confidential cost data of the impact of the reform. Consumer advocates were against the inclusion of any additional pass-through of operating costs in relation to the Consumer Data Right.⁷⁵

Our analysis indicates that the ongoing costs of complying with the Consumer Data Right lies within the range of \$0.04 to \$2.60 per customer for retailers that must be compliant with Consumer Data Right legislation by November 2023. This is based on information from Commonwealth Treasury and retailers.⁷⁶

The information before us suggests that if we base our benchmark on retailer cost data for 2021–22 consumer data right costs will be accounted for. Cost data from retailers required to comply with the consumer data right by November 2022 indicate that their 2021–22 retail operating cost data include ongoing consumer data right costs.

⁷² Competition and Consumer (Consumer Data Right) Amendment Rules (No. 2), 2021 (Cwth)

⁷³ Essential Services Commission 2022, Victorian Default Offer 2022–23: Draft decision, 15 March 2022, p. 23.

⁷⁴ Momentum submission to Consultation Paper, January 2023, p. 3; Australian Energy Council submission to Consultation Paper, January 2023, p. 4; Red Energy and Lumo Energy submission to Consultation Paper, January 2023, p. 2; Powershop submission to Consultation Paper, January 2023, p. 6; Alinta Energy submission to Consultation Paper, January 2023, p. 2; 1st Energy submission to Consultation Paper, January 2023, p. 2; EnergyAustralia submission to Consultation Paper, January 2023, p. 4–5; Energy Locals Pty Ltd submission to Consultation Paper, January 2023, p. 2.

⁷⁵ Consumer Action Law Centre submission to Consultation Paper, January 2023, p. 6; Victorian Council for Social Services submission to Consultation Paper, January 2023, p. 3.

⁷⁶ Meghan Quinn, Letter from Federal Treasury to the Office of Better Practice of Regulation, 27 October 2021.

Customer acquisition and retention costs

- Our draft decision is to keep our approach to estimating customer acquisition and retention costs (acquisition costs)
- Acquisition costs represent about two per cent of costs for the average domestic bill (averaged across the five distribution zones).
- Our decision means acquisition costs in the cost stack will slightly increase compared to those in the 2022–23 Victorian Default Offer due to inflation.

The pricing order requires us to include modest costs for customer acquisition and retention costs (acquisition costs) in making our Victorian Default Offer determinations. These costs include:

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

Our draft decision is to maintain our approach to acquisition costs

For our draft decision, we have set a modest benchmark for acquisition costs of \$43.29 excluding GST. We continue to use the benchmark of \$38 we initially established based on cost levels from Australian Competition and Consumer Commission's retail and electricity pricing inquiry final report.⁷⁷ We selected the 2013–14 benchmark on the basis that it was the most robust data available that also limited the increased spending on acquisition costs that had been observed across most jurisdictions. This has been updated for inflation in each Victorian Default Offer review.

In updating for inflation, we are maintaining the value of our benchmark in real terms over time. We consider that this approach – adopting a benchmark prior to the increase in acquisition costs across jurisdictions – meets the definition of modest. In making our decision, we do not need to have regard to the actual cost of retailers in establishing a modest benchmark.

Retailers can grow their market share by spending on acquisition costs, however spending above the level of our benchmark may not be beneficial to customers.

We note that many retailers outsource some of their customer acquisition activities. Often the contracts of these outsourced activities are indexed to consumer price index.

⁷⁷ Australian Competition and Consumer Commission, Retail electricity pricing inquiry – Final report July 2018.

We have considered stakeholder submissions on acquisition costs

We received 14 submissions on our approach to acquisition costs.

Retailers supported maintaining the current approach of adjusting the benchmark for inflation because it is a transparent, well accepted and easily understood approach.⁷⁸ While consumer advocates believed acquisition costs should be removed or that the commission should use an approach which restrains or reduces this cost component.⁷⁹

We also received three submissions from customers who supported changes in our acquisition costs. These submissions did not recommend any alternatives.⁸⁰

Consumer Action Law Centre noted their view that acquisition costs should not be included in the Victorian Default Offer. However, they acknowledged that the pricing order requires us to include modest acquisition costs. They noted the recent decline acquisition costs and recommended collecting data from retailers to understand trends in acquisition costs and adjust the benchmark accordingly. Victorian Council of Social Services encouraged the commission to seek the best available information on the modest acquisition costs. Their raised concerns that the current approach risks unwarranted increases in the cost stack. They recommended an approach which restrains or reduces this component.⁸¹

While we understand the concerns that consumers and their advocates have about acquisition costs, customers can benefit from acquisition costs. Modest expenditures on acquisition activities can help make customers aware of the different offers available in the market and promote competition between retailers. However, spending on customer acquisition can turn into an 'arms race' where retailers spend more and more in attempts to increase their market share with no extra benefit to customers.

The information that we have on retailers' actual customer acquisition costs show that on average they are higher than our benchmark amount. It is not clear what additional customer benefits

⁷⁸ Energy Locals Pty Ltd submission to Consultation Paper, January 2023, p. 2; Origin Energy submission to Consultation Paper, January 2023, p. 3-6; Alinta Energy submission to Consultation Paper, January 2023, p. 2; Red Energy and Lumo Energy submission to Consultation Paper, January 2023, p. 1-2; Australian Energy Council submission to Consultation Paper, January 2023, p. 4; Momentum Energy submission to Consultation Paper, January 2023, p. 3; Simply Energy submission to Consultation Paper, January 2023, p. 2-4; EnergyAustralia submission to Consultation Paper, January 2023, p. 1-4.

⁷⁹ Victorian Council of Social Services submission to Consultation Paper, January 2023, p. 3; Consumer Action Law Centre submission to Consultation Paper, January 2023, p. 6.

⁸⁰ Errol Muir submission to Consultation Paper, December 2022, p. 1; Candice Miles submission to Consultation Paper, December 2022, p. 1; Angela Hood submission to Consultation Paper, January 2023, p. 2.

⁸¹ Victorian Council of Social Services submission to Consultation Paper, January 2023, p. 3; Consumer Action Law Centre submission to Consultation Paper, January 2023, p. 6.

retailers' current expenditures on customer acquisition costs provide relative to what retailers were spending in 2013–14 (the year our current acquisition cost benchmark is from). This suggests retailers' actual expenditures continue to be above the modest level required in the pricing order. For this reason, we intend to maintain our past approach to acquisition costs. A recent review by the Victorian Government also found that this approach was operating satisfactorily.⁸²

Nonetheless we will continue to gather information from retailers on the trends in acquisition costs. If the information we gather suggests a different approach may be required, then we will give further consideration to our approach to acquisition costs.

Other costs

- Our draft decision is to set a benchmark for other regulatory costs that are based on the latest available market information. These costs include:
 - market intervention costs
 - Australian Market Operator fees
 - ancillary fees
 - Reliability and Emergency Reserve Trader costs
 - Essential Services Commission license fees.
- Other costs make up around slightly less than one per cent of total costs for a representative customer (averaged across the five distribution zones).
- Our draft decision would marginally increase the amount included for these costs compared with the 2022–23 Victorian Default Offer primarily due to the inclusion of market intervention costs.

This section outlines regulatory costs which are incurred by electricity retailers that are specific and discrete to their obligations and requirements to operate as an electricity retailer. These regulatory costs are generally minor, relative to the total cost stack (less than one per cent) but are a relevant factor in our estimation of the efficient cost of the sale of electricity by a retailer.⁸³

⁸² Department of Environment, Land, Water, and Planning 2022, Review of the Victorian Default Offer Order in Council, Final decision, October 2022, p. 26-27.

⁸³ Clause 12(4)(f) of the [pricing order](#).

Our draft decision is to pass through the regulatory costs that electricity retailers incur. These costs include:

- Market intervention costs
- Australian Energy Market Operator fees
- Ancillary fees
- Reliability and Emergency Reserve Trader costs
- Essential Services Commission License fees.

Market intervention costs

Wholesale electricity prices increased significantly in early 2022. Following this, the Australian Energy Market Operator took temporary steps to stabilise the market in June 2022. These included introducing an Administered Price Cap on wholesale electricity prices and suspending the wholesale market and directing generators to supply as required.⁸⁴ Generators incurred costs because of these actions.

Electricity generators who were financially disadvantaged during these events can make compensation claims. If the claims are successful, the value of the costs successfully claimed are then passed on to electricity retailers. The process for these claims is set out in the National Energy Rules.⁸⁵

The total cost that electricity retailers will face because of the Australian Energy Market Operator's intervention are made up of:

- directions compensation
- suspension pricing compensation
- administered pricing compensation
- Reliability and Emergency Reserve Trader payments.

Directions and suspension pricing compensation

Directions compensation and suspension pricing compensation are administered by the Australian Energy Market Operator. These forms of compensation allow generators to recover costs above the wholesale electricity price, at the time they were directed to supply (directions compensation) or during the period of market suspension (suspension pricing compensation).

⁸⁴ For more information on the June 2022 market event see: [AEMO Guide to Market Suspension in the NEM](#).

⁸⁵ For more information see: [AEMC National Electricity Rules - Rule 3.14 Administered Price Cap and Market Suspension](#). Accessed 16 January 2023.

The Australian Energy Market Operator assessed directions and suspension pricing compensation for electricity generators in two tranches (provisional and revision amounts) across the last half of 2022. On 6 January 2023, the Australian Energy Market Operator determined \$113.1 million for directions and suspension pricing compensation to be recovered from the national energy market, with \$28.03 million allocated to Victoria.⁸⁶

Administered pricing compensation

Administered pricing compensation is administered by the Australian Energy Market Commission. This allows generators to recover their costs when they are higher than the revenue they receive under the Administered Price Cap. This form of compensation can be claimed for both direct costs and opportunity costs.

Electricity generators can submit a claim for compensation relating to the administered pricing to the Australian Energy Market Commission for assessment and decision. The Australian Energy Market Commission decided on three claims in December 2022.⁸⁷ The compensation finally determined in relation to these claims was referred to the Australian Energy Market Operator to be recovered from the national energy market according to the demand of relevant electricity retailers for energy at the time of the event. Of the three finalised claims the Australian Energy Market Operator has allocated \$0 to Victoria.⁸⁸

Reliability and Emergency Reserve Trader costs

The Reliability and Emergency Reserve Trader scheme is a mechanism that the Australian Energy Market Operator can use to maintain power system reliability. During the June 2022 event, this scheme was not activated in Victoria, so there will be no costs to pass through from this event.⁸⁹

Our draft decision is to include known market intervention costs

Our decision is to include the costs incurred by energy retailers because of market intervention events in the 2023–24 Victorian Default Offer. These costs are unavoidable for energy retailers and passing through these costs will allow retailers to recover their efficient costs. This approach is

⁸⁶ [Australian Energy Market Operator June 2022 NEM Events: Compensation Update \(6 January 2023\)](#), accessed 16 January 2023.

⁸⁷ For more information see: [AEMC Administered pricing compensation claims relating to June 2022 event](#), accessed 16 January 2023.

⁸⁸ [Australian Energy Market Operator June 2022 NEM Events: Compensation Update \(6 January 2023\)](#), accessed 16 January 2023.

⁸⁹ Reserves were contracted for Victoria on Friday 17 June with a duration between 3 to 5 hours but not activated in Victoria. Australian Energy Market Operator, [Reliability and Emergency Reserve \(RERT\) End of Financial Year 2021-22 Report](#), August 2022 page 4-6.

consistent with the requirement in the pricing order to base Victorian Default Offer prices on efficient costs.⁹⁰

A prudent energy retailer will hedge (often through futures) their wholesale market exposure to protect them from volatility in spot prices. When the Australian Energy Market Operator intervened in the wholesale market, it effectively exposed retailers to higher wholesale costs but capped the revenue retailers could receive through hedging.⁹¹ There is no mechanism for retailers to claim compensation from the Australian Energy Market Operator for the lost hedging revenue that would have offset the higher wholesale costs. As a result, we would expect an efficient retailer to pass market intervention costs through to their customers.

Market intervention costs will be included as a variable cost (not a fixed cost). Market intervention costs that have not been decided by the Australian Energy Market Commission and allocated to the national energy market at the time we make our final decision on the 2023–24 Victorian Default Offer will not be included in the 2023-24 Victorian Default Offer price determination, but will be accounted for when we make our determination on the 2024–25 Victorian Default Offer. Our draft decision calculates the finally decided and allocated market intervention costs at the date of making this draft decision by dividing 2022–23 forecast electricity customers' usage by the provisional and revision costs known as of 6 January 2023.⁹² The currently known market intervention costs included in our draft decision for the 2023–24 Default Offer are **\$0.80 cents per megawatt hour**. When adjusted for network losses and separated by distribution zone the bill impact for domestic customers ranges from \$3.86–\$4.02 per customer.

Most submissions supported including market intervention costs in the Default Offer

Our draft decision is to pass-through all finally decided and allocated market intervention costs at the date of making our final 2023-24 Victorian Default Offer final decision. The extent of already decided and allocated market intervention costs as of early March 2023 have been outlined above. These costs have been taken into account in making this draft decision. In our final decision we will pass-through any further market intervention costs that are finally decided by the Australian Energy Market Commission and allocated to Victoria prior to the last Friday of April 2023.

⁹⁰ Clause 12(3) of the pricing order.

⁹¹ For more information on the market intervention events see <https://aemo.com.au/energy-systems/electricity/emergency-management/guide-to-market-suspension-in-the-nem>.

⁹² [Australian Energy Market Operator June 2022 NEM Events: Compensation Update \(6 January 2023\)](#), accessed 16 January 2023

We received four submissions that opposed the inclusion of these costs to varying degrees.⁹³

While we acknowledge that consumers are facing significant cost pressures across the economy, the costs resulting from the market intervention are unavoidable for energy retailers. Passing through these costs will allow retailers to recover their efficient costs. This approach is consistent with the pricing order to base Victorian Default Offer prices on electricity retailers' efficient costs.⁹⁴

Submissions were mixed on how to account for residual market intervention costs

Our consultation paper sought stakeholders' views on how costs resulting from the June 2022 market intervention should be reflected in Victorian Default Offer prices. We received mixed views on how to account for any residual costs that may be determined by the Australian Energy Market Commission after our final decision on the 2023–24 Victorian Default Offer. Some submissions suggested we include an estimate of residual costs in the 2023–24 Victorian Default Offer mainly to reduce the financial burden or risk of under recovering these costs during the regulatory period and some suggested we provide an uplift in the retail margin to account for this risk.⁹⁵

Our draft decision does not include an estimate of residual compensation costs that may be incurred in 2023–24. These residual costs are yet to be finally decided by the Australian Energy Market Commission and allocated by the Australian Energy Market Operator to the national energy market and are therefore unknown. The Australian Energy Market Commission has not publicly disclosed any estimates of the value of residual compensation cost amounts.

Our final decision will be updated to include any relevant residual costs that may be determined by the Australian Energy Market Commission and administered and settled by the Australian Energy Market Operator by the last Friday of April 2023.

Submissions did not support a variation to the 2023–24 Victorian Default Offer to account for residual market intervention costs

Our consultation paper sought stakeholders' views on how additional market intervention costs that become known after our final decision on the 2023–24 Victorian Default Offer should be accounted

⁹³ Anonymous 1 submission to Consultation Paper, December 2022, p.2; Michael Tierney submission to Consultation Paper, January 2023, p. 1; Consumer Action Law Centre submission to Consultation Paper, January 2023, p. 3-4, Victorian Council of Social Service submission to Consultation Paper, January 2023, p. 1-2.

⁹⁴ Clause 12(3) of the pricing order.

⁹⁵ 1st Energy submission to Consultation Paper, January 2023, p. 1; AGL submission to Consultation Paper, January 2023, p. 2; Alinta Energy submission to Consultation Paper, January 2023, p. 1-2; Red Energy and Lumo Energy submission to Consultation Paper, January 2023, p. 2-3; Australian Energy Council submission to Consultation Paper, January 2023, p. 3; Energy Locals Pty Ltd submission to Consultation Paper, January 2023, p. 1-2; Momentum submission to Consultation Paper, January 2023, p. 2; Origin Energy submission to Consultation Paper, January 2023, p. 3.

for. We asked stakeholders for their views on whether we should include additional costs in the 2024–25 Victorian Default Offer, or as a passthrough variation to the 2023–24 Victorian Default Offer.⁹⁶ Seven submissions did not support a variation to the 2023-24 Victorian Default Offer price determination solely to account for residual intervention costs. These submissions considered that residual costs being included in the 2024–25 Default Offer was appropriate or that a variation was merited only if the costs were found to be highly material.⁹⁷ One energy retailer said:

While it would be beneficial to recover these costs close to the time they are incurred, preparing and implementing price change processes is a costly exercise for retailers and a midcycle price increase is not a good experience for customers. Unless the intervention costs are of a very significant magnitude, Simply Energy would support the recovery of these costs being deferred to the 2024–25 VDO price determination.⁹⁸

Our draft decision is to retain our variation of price determination mechanism specified in clause 6 of the current 2022-23 Victorian Default Offer price determination. This will be included in our 2023-24 Victorian Default Offer price determination. This sets out the circumstances under which we may, in our discretion, consider and decide on a proposed variation. It also sets out the relevant matters we will have regard to when considering whether an event is sufficiently material to warrant a variation. This mechanism will guide whether or not we vary the 2023–24 Victorian Default Offer price determination to account for market intervention costs that are finally decided by the Australian Energy Market Commission and allocated by the Australian Energy Market Operator to the national energy market after our 2023-24 Victorian Default Offer final decision, but before we pass these costs through in our 2024–25 Victorian Default Offer decision.

Australian Energy Market Operator fees

These fees are charged to electricity retailers by the Australian Energy Market Operator (market operator) to recover the costs of market operation. For the 2022–23 Victorian Default Offer we based our estimate of the market operator’s fees on its 2022–23 draft budget fees and charges.⁹⁹

⁹⁶ For circumstances which the commission may consider and decide on a proposed variation see clause 6 Victorian Default Offer Price Determination 2022–23, pp. 7-9.

⁹⁷ GloBird Energy submission to Consultation Paper, December 2022, Simply Energy submission to Consultation Paper, December 2022, Alinta Energy submission to Consultation Paper, December 2022, Consumer Action Law Centre submission to Consultation Paper, December 2022, Powershop submission to Consultation Paper, December 2022, EnergyAustralia submission to Consultation Paper, December 2022, VCOSS – Victorian Council of Social Service submission to Consultation Paper, December 2022.

⁹⁸ Simply Energy submission to Consultation Paper, January 2023, p. 1-2.

⁹⁹ Australian Energy Market Operator, [2022-23 AEMO Budget and Fees](#), May 2022.

We include a range of charges and fees that the market operator allocates to market participants (electricity retailers). These include:

- general National Energy Market fees
- National Transmission Planner fees
- Distributed Energy Resources Integration Program costs
- IT and 5MS/GC compliance costs
- Energy Consumers Australia fees
- Full Retail Contestability operations fees.

For our draft decision we have based our estimate on the approved 2022–23 budget fees and charges and applied a 4.5 per cent increase as the best estimate for the fees to apply for 2023–24.¹⁰⁰ We have also maintained the portion of general fees allocated to market participants for 2022–23.

Usually the market operator's fee structure allocates 70 per cent between market customers and wholesale participants (generators).¹⁰¹ A recent change to the National Electricity Rules allows Transmission Network Service Providers (TNSP) to recover the cost of their market operator fees which has changed the proportions of fees that are allocated between market customers, generators and TNSP's from 1 July 2023.¹⁰² Up until 30 June 2023, market customers are allocated 54.4 per cent of allocated fees, whereas the recent rule change reduces this to 26.6 per cent.

The total cost recoverable for the market operators' fees for the average domestic bill for 2023–24 is \$6.11. For our final decision we will update this component to the 2023–24 fees and the proportion allocated to market participants that applies from 1 July 2023, if available at the time of making our decision.

Ancillary Fees

Ancillary services are used by the market operator to manage the power system safely, securely, and reliably, for frequency, voltage, and system restart processes. The market operator provides these ancillary services separately for each market that they operate. Unlike other charges, the

¹⁰⁰ Australian Energy Market Operator expect to require a 4.5 per cent increase in their fee pathway for 2023–24. 2022–23 AEMO Budget and Fees, May 2022, page 7.

¹⁰¹ The residual 30 per cent of fees are 'unallocated' but recovered through market customers. For allocation change see: [AEMO Electricity Fee Structures March 2021](#), table 2 page 6.

¹⁰² For more information see: [AEMC Rule change: Recovering the cost of AEMO's participant fees](#) October 2022, accessed 16 January 2023.

market operator's ancillary service fees differ across these different markets, and so are not included in the Australian Energy Market Operator fees.

The relevant charges depend on the amount of service required at any particular time, which means the costs will vary from period to period. We analysed market operator data to estimate Victorian ancillary charges in the regulatory period beginning 1 January 2022. We used an average of the past 52 weeks (ending 26 December 2022) of ancillary service payments in Victoria. This results in an average ancillary service payment of \$0.42 per megawatt hour. This is an increase of 7 cents per megawatt hour from the 2022–23 Victorian Default Offer determination.

Essential Services Commission licence fees

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

We used a market wide total of all retailer licence fees for 2022–23 divided by the total number of customers for the same period in estimating the cost of a licence fee per customer for the 2023–24 Victorian Default Offer. The latest approved licence fees are for 2022–23. Adjusting this data for inflation results in a benchmark of \$2.23 per customer per year.

Retail operating margin

- Our draft decision is to continue to use the benchmarking retail operating margin we used in our last Victorian Default Offer decision.
- The retail operating margin represents 5.7 per cent of costs for the representative user.
- Our draft decision means that the dollar value of the retail operating margin in the domestic cost stack will increase by 31 per cent (on average across Victoria's five distribution zones) relative to the amount in the 2022–23 Victorian Default Offer.

The pricing order requires us to have regard to the retail operating margin when making a Victorian Default Offer price determination.¹⁰³

The retail operating margin represents the operating profit margin required to compensate investors for the capital provided to operate a retail service. It includes the cost of capital, and the

¹⁰³ Clause 12(4)(e) of the pricing order.

systematic (non-diversifiable) risk associated with investment.¹⁰⁴ The retail operating margin is expressed as a percentage of the cost stack.¹⁰⁵ 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.

We propose to keep the retail operating margin at 5.7 per cent

We received submissions that the retail operating margin should go up and others that advocated for the margin to go down.

There is some evidence that the retail margin should be lower. In particular, retailers' actual margins appear lower than the benchmark we have set. On the other hand debt costs, which contribute to the costs covered by the retail operating margin, have increased. Our current retail operating margin is also within the range of margins adopted by other Australian regulators. Given that there is no clear indication that we should lower or increase our margin, and it is within the range of margins set by other regulators, we have kept the retail operating margin unchanged for the time being.

As part of this review, we investigated the current margins and the methodologies adopted in other jurisdictions for 2022–23. We found the range of retail margins set by Australian regulators in their latest regulatory decisions was between 4.8 and 15 per cent. This is shown in Table 3 below which indicates our current margin of 5.7 per cent is within the range of retail operating margins set by regulators in similar jurisdictions.

Table 3 Implied retail margins for domestic customers in other Australian jurisdictions

Regulator	Approach	Point estimate or range
Australian Energy Regulator	The retail allowance benchmark ranges between 10 per cent and 15 per cent for domestic customers. ¹⁰⁶ The Default Market Offer (DMO) benchmark encompasses a retail margin and an	10%-15%

¹⁰⁴ Non-diversifiable risks are considered to be unavoidable and are typically attributable to market factors that affect all firms.

¹⁰⁵ The term margin is used as an estimate of profit divided by sales. Holding the percentage earnings before interest, taxes, depreciation and amortization (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.

¹⁰⁶ Australian Energy Regulator, Default market offer prices 2022–23: Final determination, May 2022, p. 49.

additional benchmark to achieve the DMO objectives.		
Independent Competition and Regulatory Commission	5.6 per cent of cost components (equivalent to 5.3 per cent of the total cost stack) for the 2020–24 regulatory period.	5.3%
Office of the Tasmanian Regulator	5.25 per cent of approved costs in 2022–23 and will be fixed as a dollar per customer benchmark to be escalated by Hobart Consumer Price Index for 2023–24 and 2024–25.	5.25%
Queensland Competition Authority (QCA)	Not explicitly determined. QCA sets an overall total retail costs allowance which is recovered through fixed and variable charges. Retail costs consist of 15 per cent of a typical domestic bill.	4.8%*

*This is based on an assumed retail operating cost of \$132/customer.

We have also looked into the level of retail margins in Victoria. To do this we used actual retail electricity cost and revenue cost data submitted by Victorian retailers for the 2020–21 financial year. The assessment indicated that the average retail margin, denoted by their earnings before interest, taxes, depreciation and amortization, was 4.8 per cent. This is roughly in line with the margin allowed in the Victorian Default Offer. This suggests that the retailer operating margin in our cost stack provides retailers with a sufficient return.

There is no clear evidence that the margin should change

In general, stakeholders were of the view that the retail operating margin should be changed. Consumer groups were of the view that the margin is now too generous, while retailers considered that with emerging market risks it may be too low.

In response to our initial consultation on the 2023–24 Victorian Default Offer, some retailers, submitted that the retail operating margin benchmark should increase to account for the recent increases in debt finance costs.¹⁰⁷

When we engaged Frontier Economics to estimate a range of the retail margin based on the expected returns approach in 2019, the resulting range of the margin was between 4.8 to 6.1 per cent, based on nominal cost of debt ranging between 4.50 per cent and 6.12 per cent and a cost of equity ranging between 8.25 per cent and 9.37 per cent.¹⁰⁸ In the interim, the cost of equity in the energy sector has reportedly decreased while cost of debt also decreased between 2020 and 2022.¹⁰⁹ While interest rates have increased over the past year, we note that retailers' debt portfolios only partly roll over year to year. As a result, the recent increases in debt costs will not affect all of the debt held by retailers.

Some retailers have also cited the higher volatility in the wholesale electricity market, and increased credit support requirements¹¹⁰ as an indication that retailers now operate in a high-risk environment and should be provided with a greater risk premium.¹¹¹

For the 2022–23 financial year, our approach to estimating wholesale costs for the Victorian Default Offer meant that a prudent retailer, who would have adopted a similar hedging strategy, would not be impacted by large increases in spot prices since they enter the quarter mostly hedged. This is in line with the assessment that such retailers would receive material net payments when spot prices increase a lot more than the contract prices.

Consumer Action Law Centre submitted that the current margin requires review.¹¹² It noted that the ACCC's most recent report from their Inquiry into the National Energy Market shows a general downward trend in retail margins across the National Electricity.¹¹³ A submission from Energy

¹⁰⁷ Energy Locals Pty Ltd submission to Consultation Paper, January 2023, p. 1; GloBird Energy submission to Consultation Paper, January 2023, p. 3; Powershop submission to Consultation Paper, January 2023, p. 4.

¹⁰⁸ Frontier Economics, Retail costs and margin: A report for the Essential Services Commission, April 2019, p. 24-30. These figures are adjusted for inflation.

¹⁰⁹ This is based on the Australian Energy Regulator's cost of equity used in Victorian distribution network decisions for the period 2021-26.

¹¹⁰ Australian Energy Council submission to Consultation Paper, January 2023, p.3, Energy Locals Pty Ltd submission to Consultation Paper, p. 3,

¹¹¹ Red Energy and Lumo Energy submission to consultation paper, January 2023, p. 1.

¹¹² Consumer Action Law Centre submission to Consultation Paper, January 2023.

¹¹³ Australian Competition and Consumer Commission, Inquiry into the National Electricity Market, November 2022, pp 72-73.

Consumers Australia also echoes similar concerns whether the current retailer margin remain justifiable.¹¹⁴

While there is some evidence in the ACCC's report that actual margins may have decreased over recent years, as mentioned above, we note that debt finance costs have increased. As a result, it is not immediately clear whether retail margins should increase or decrease.

For these reasons, and the results of our analysis of retailers' actual margins, we do not propose to adjust the retail operating margin in the 2023–24 Victorian Default Offer but will continue to monitor how retailers' actual margins compare to our benchmark.

¹¹⁴ Energy Consumers Australia submission to Consultation Paper, January 2023, p 3.

Calculating tariffs and the maximum annual bill

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

- **flat tariffs** - for standing offers with flat tariffs
- **two-period time of use tariffs** – for standing offers with two-period time of use tariffs
- **the maximum bill** - for standing offers with non-flat tariffs, other than two-period time of use tariffs.

The compliant maximum annual bill is based on the two-period time of use tariffs.

Tariff structure

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

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

Our draft decision on flat tariffs

Our draft decision is to use the same approach to setting standing offer rates for flat tariffs as we did in our 2022–23 Victorian Default Offer price determination. Under this approach, we align the tariff structures with the underlying flat network tariffs in each distribution zone.

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

Flat tariff cost allocation

Daily supply charge (fixed costs) =

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

Usage charge (variable costs) =

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

Our draft decision on two-period time of use tariffs

Our draft decision is to use the same approach to setting standing offer rates for two-period time of use tariffs as we did in our 2022–23 Victorian Default Offer price determination. Under this approach, we align the tariff structures with the underlying two-period time of use network tariffs.

Cost allocation

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

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

Cost allocation two-period time of use tariffs

Daily supply charge (fixed costs) =

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

Peak usage charge (variable costs) =

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

Off peak usage charge (variable costs) =

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

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

In addition to setting the flat and two-period time of use tariffs described, our draft decision is to regulate all other standing offers (for example, non-standard time of use and demand tariffs) through a compliant maximum annual bill. The compliant maximum annual bill amount is calculated based on the two-period time of use tariffs. This is consistent with the approach we took in the 2022–23 Victorian Default Offer.

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

Annual reference consumption amount

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

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

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

Representative usage profiles and related usage allocations

We have not updated the usage profiles for calculating the compliant maximum annual bill amounts for the 2023–24 Victorian Default Offer determination. We have examined changes in the share of load but there have not been significant changes since 2020–21.

The usage profiles in tables 4 and 5 are based on the load data for the 2020–21 financial year. We used manually read interval meter data provided by the Australian Energy Market Operator to calculate these profiles.

Table 4: Domestic – usage profile for maximum bill calculation

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

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

Customer class	Peak period	Off peak
Time period window	9.00am–9.00pm weekdays	All other times
Usage profile	0.47	0.53

Calculating the compliant maximum annual bill amount

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

- annual reference consumption amount
- usage profiles as specified in tables 4 and 5
- two-period time of use tariffs determined by the commission for each distribution zone.

Retailers must show they comply with the maximum annual bill amount

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

A retailer's estimated annual electricity bill for a non-standard tariff must be calculated using the relevant annual reference consumption amount determined by the commission, apportioned according to the retailer's relevant published representative usage profile and multiplied by the retailer's relevant non-standard tariffs.

Consultation papers

In our consultation paper for the 2023-24 Victorian Default Offer, we proposed to consult on Victorian Default Offer decisions by releasing a draft decision. We proposed only to publish consultation papers prior to a draft decision if we were considering significant changes.

Our draft decision is to publish 'request for comment' notices at the start of our reviews.

Following stakeholder submissions, we have changed our proposal

In general, the proposals we received were in favour of continued publication of consultation papers.¹¹⁵ Reasons for this include:

- During times of economic volatility more frequent consultation may be of benefit
- Consultation papers give stakeholders an opportunity to publicly raise concerns about changes in the market how the ESC should account for these concerns
- While the Victorian Default Offer methodology is well established it is still not entirely settled

Some stakeholders submitted alternative options for example Consumer Action Law Centre submitted:

*In future years when a consultation paper is not published, the ESC releases an earlier draft decision so that stakeholders have time to review the decision and respond.*¹¹⁶

Another option was presented by AGL:

*If the ESC has no immediate concerns with the VDO methodology then AGL supports the ESC simply releasing a short request for comment or submissions rather than producing a rigorous Consultation Paper.*¹¹⁷

While we consider that in most cases a comprehensive consultation paper is not required, given that stakeholders see value in a formal opportunity for public comment we propose to publish 'request for comment' notices to publicly start our reviews.

¹¹⁵ 1st Energy submission to Consultation Paper, January 2023, p. 2; Alinta Energy submission to the Consultation Paper, January 2023, p. 1; AGL submission to Consultation Paper, January 2023, p. 3; Momentum Energy submission to Consultation Paper, January 2023, p. 3; Australian Energy Council submission to Consultation Paper, January 2023, p. 5; Consumer Action Law Centre submission to Consultation Paper, December 2022, p. 7.

¹¹⁶ Consumer Action Law Centre submission to Consultation Paper, December 2022, p. 7.

¹¹⁷ AGL submission to Consultation Paper, January 2023, p. 3.

Appendix A: Our legislative considerations

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

The commission's power to determine the Victorian Default Offer

The Victorian Default Offer price determination is a determination for purposes of section 33 of the Essential Services Commission Act 2001 (ESC Act). In making a Victorian Default Offer price determination we must adopt an approach and methodology in accordance with section 33(2) of the ESC Act, and the pricing order.¹¹⁸ Taken together, this means we must adopt an approach and methodology we consider will best meet the objectives specified in the ESC Act, the commission's objectives under the Electricity Industry Act 2000 (EI Act) and the objective of the Victorian Default Offer.¹¹⁹

The pricing order gives the commission discretion to decide the approach and methodology to be used for making this Victorian Default Offer price determination.¹²⁰ This is however subject to the requirement that the Victorian Default Offer price determination must be based on the efficient costs of the sale of electricity by a retailer,¹²¹ having regard to:¹²²

- wholesale electricity costs
- network costs
- environmental costs
- retail operating costs, including only modest costs of customer acquisition and retention¹²³
- retail operating margin¹²⁴
- any other costs, matters or things we consider appropriate or relevant.

¹¹⁸ Clause 12(1) of the pricing order.

¹¹⁹ Best meeting the objective of the Victorian Default Offer is a requirement of clause 12(2) of the pricing order.

¹²⁰ Clause 10(3) of the pricing order read with section 33(5) of the Essential Services Commission Act 2001.

¹²¹ Clause 12(3) of the pricing order. Further, clause 12(8) affirms that the pricing order does not require the commission to determine tariffs based on the actual costs of a retailer.

¹²² Clause 12(4) of the pricing order.

¹²³ Clause 12(6) of the pricing order specifies that this is to be an amount determined by the commission in its discretion.

¹²⁴ Clause 12(7) of the pricing order specifies that this is to be an amount determined by the commission in its discretion, and in doing so regard must be had to (without limitation) the principle that the margin must not compensate retailers for risks that are compensated elsewhere in the costs. Clause 12(9) of the pricing order affirms that the commission is not required to determine tariffs based on the actual retail operating margin of a retailer.

The pricing order also specifies that we must not include headroom.¹²⁵

Our objectives in setting the Victorian Default Offer

The objective of the commission under the ESC Act is to promote the long-term interests of Victorian consumers, having regard to the price, quality and reliability of essential services.¹²⁶

As objectives of the EI Act, the commission must adopt an approach which promotes protections for customers, the development of full retail competition and a consistent regulatory approach between the electricity and gas industries (noting there is currently no framework for the regulation of prices for retail gas services).¹²⁷

The objective of the Victorian Default Offer under the pricing order is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.¹²⁸

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

Other matters the commission must have regard to when determining tariffs

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

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

¹²⁵ Clause 12(10) of the pricing order; 'headroom' being defined in clause 4(1) as 'an allowance that does not reflect an efficient cost borne by firms operating in the market.'

¹²⁶ Essential Services Commission Act 2001, s 8.

¹²⁷ Electricity Industry Act 2000, s 10.

¹²⁸ Clause 3 of the pricing order sets out the objective of the Victorian Default Offer.

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

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

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

In addition, section 33(4)(b) of the ESC Act provides that in making a determination, the commission must ensure that the determination takes into account and clearly articulates any trade-offs between costs and service standards.¹²⁹

¹²⁹ Under clause 12(11) of the pricing order, section 33(4)(a) does not apply to a Victorian Default Offer determination.

Appendix B: Order in council



Victoria Government Gazette

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

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

Order in Council

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

1. **Purpose**

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

2. **Commencement**

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

3. **Objective of the Victorian default offer**

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

4. **Definitions**

1. In this Order:

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

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

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

Example: A storage water heater is such an appliance.

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

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

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

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

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

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

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

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

(a) the time of day;

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

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- (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;
 - (d) retail operating costs, including modest costs of customer acquisition and

- retention;
 - (e) retail operating margin; and
 - (f) subject to subclause (10), any other costs, matters or things the Commission, in the exercise of its discretion, considers appropriate or relevant.
- Note: Section 33(3)(e) of the ESC Act similarly requires the Commission to have regard to any other factors that it considers relevant.

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

Notes:

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

13. Variation of VDO price determinations

1. Before or during a regulatory period, the Commission may, on its own initiative, vary a VDO price determination in respect of the regulatory period.
2. The Commission must specify, in a VDO price determination, the circumstances under which the Commission will consider, and the basis on which the Commission will decide on, a proposed variation and (subject to subclauses (4) and (5)) the processes to be followed to enable the Commission to make such a variation.
3. Without limiting subclause (1), the Commission may vary a VDO price determination:
 - (a) if an event has occurred or will occur that was uncertain or unforeseen by the Commission at the time of making the VDO price determination; or
 - (b) to correct a clerical error, miscalculation, misdescription or other deficiency.
4. Before making a variation, the Commission must consult in accordance with clause 14.
5. Subclause (4) does not apply if:
 - (a) the variation is not sufficiently material to warrant consultation in accordance with clause 14; or
 - (b) the need for the variation is sufficiently urgent to warrant consultation in accordance with clause 14 not being undertaken.

6. If, as a result of a variation of a VDO price determination, a retailer is or will be required to vary the retailer's standing offer tariffs, the Commission must ensure the retailer is given adequate notice before the variation to the VDO price determination takes effect.
- 14. Consultation**
1. The Commission may decide the nature and extent of stakeholder consultation it will undertake when making a VDO price determination or a decision to vary a VDO price determination.
 2. For the purposes of subclause (1), the Commission must have regard to its Charter of Consultation and Regulatory Practice (as amended from time to time) developed and published under section 14 of the ESC Act.
- 15. Victorian default offer tariffs to be the reference tariffs for discounts**
1. This clause applies until such time as the amendments to the Energy Retail Code required by clause 16(2)(a) come into force.
Provided that, if those amendments do not provide for any matter provided for in this clause, then this clause continues to apply in respect of that matter.
 2. A retailer that offers a discount to a domestic customer or a small business customer must:
 - (a) if the discount is in respect of the period from 1 July 2019 to 31 December 2019, disclose how the discount is calculated as against the tariffs in Schedule 1 or Schedule 2 (as the case may be), and what (in percentage or dollar terms) the reduction in tariff is in terms of those tariffs; and
 - (b) if the discount is in respect of a regulatory period, disclose how the discount is calculated as against the flat tariffs determined by the Commission pursuant to the VDO price determination that applies in respect of that period, and what (in percentage or dollar terms) the reduction in tariffs is in terms of those tariffs.
 3. For the purposes of subclause (2), the reduction in tariffs is to be expressed as the difference between the estimated annual cost of the Victorian default offer for the customer type and distribution zone, and the estimated annual cost of the offer to which the discount relates after the discount is applied, using the annual reference consumption.
 4. For the purposes of subclause (3):
 - (a) the estimated annual cost of the Victorian default offer is:
 - i. during the period from 1 July 2019 to 31 December 2019, determined by applying Schedule 3;
 - ii. during a regulatory period, determined by applying Schedule 3 or any other approach or methodology determined by the Commission; and
 - (b) the retailer must determine the estimated annual cost of the retailer's offer to which the discount relates:
 - i. if the tariff is a flat tariff or a flexible tariff (in either case, with or without a controlled load), by applying Schedule 3;
 - ii. otherwise, based on a reasonable estimate having regard to any relevant information available to the retailer; and

5. The annual reference consumption is:
 - (a) during the period from 1 July 2019 to 31 December 2019:
 - i. for domestic customers without a controlled load – 4,000 kWh general usage per annum;
 - ii. for domestic customers with a controlled load – 4,000 kWh general usage plus 2,000 kWh controlled load usage per annum;
 - iii. for small business customers (with or without a controlled load) – 20,000 kWh general usage per annum.
 - (b) during a regulatory period:
 - i. the consumption amount determined by the Commission (if any); or
 - ii. if no amount is determined by the Commission pursuant to subclause (5)(b)(i), the amount specified in subclause (5)(a).
 6. For the purposes of subclause (5), the amount of electricity consumed is assumed to be the same on each day of the year.
 7. Any percentage or dollar amount disclosed pursuant to this clause must be expressed as a whole percentage or dollar, rounded to the nearest percentage or dollar.
 8. Otherwise, Division 2 of Part 2A (*Customers entitled to clear advice*) of the Energy Retail Code applies to the disclosures required by this clause.
- 16. Direction to the Commission pursuant to section 13(3)(b) of the Act**
1. The Commission must, as soon as practicable after the commencement of this Order, amend the Energy Retail Code and any other instrument of the Commission to give effect to the Victorian default offer and this Order.
 2. Without limiting subclause (1), the Commission must amend the Energy Retail Code (and any other instrument of the Commission) so that the Code:
 - (a) provides for tariffs determined by the Commission pursuant to the VDO price determination being the reference tariffs for discounts and for the methodology of that comparison; and
 - (b) requires a retailer's electricity bill to include information about how the customer may access the Victorian default offer from the retailer.
 3. For the purposes of subclause (2)(a), the Commission must have regard to the following principles:
 - (a) There must be a consistent methodology for comparison of tariffs that applies to:
 - i. all offers of discounts by retailers; and
 - ii. the advertising in respect of those discounts.
 - (b) The methodology must apply in respect of flat tariffs and tariffs that are not flat tariffs;
 - (c) The methodology must (without limitation) readily allow, in respect of a regulatory period, a comparison between:
 - i. the discounted tariffs offered by a retailer; and
 - ii. the tariffs determined by the Commission pursuant to the VDO price determination in respect of that period; and
 - (d) Any actual comparison in accordance with the methodology must be readily understandable by a prescribed customer.

4. Subclause (3) does not limit:
 - (a) the matters the Commission may have regard to; or
 - (b) the matters the Commission may provide for by way of the amendments required by subclause (2).

17. Review of the operation of this Order

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

SCHEDULE 1

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

Charges are inclusive of GST.

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

SCHEDULE 2

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

Charges are inclusive of GST.

Distribution zone	Supply charge (\$ per day)	Usage charge structure	Usage charge (\$ per kWh)
AusNet Services	\$1.1368	Block 1 (up to 1020 kWh during a quarter)	\$0.3154
		Block 2 (> 1020 kWh during a quarter)	\$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;

UA_s 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
ORDER UNDER SECTION 17 OF THE
ELECTRICITY INDUSTRY ACT 2000

Order in Council

The Lieutenant-Governor, as the Governor's deputy, with the advice of the Executive Council makes the following Order under section 17 of the **Electricity Industry Act 2000**:

1. Purpose

The purpose of this Order is to amend the transitional pricing rule in the Order in Council made under section 17 of the **Electricity Industry Act 2000** and published in the Government Gazette No. S 390 on 15 November 2017 (*General Exemption Order*).

2. Commencement

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

3. Amendments

- 3.1. In clause 10(1) of the General Exemption Order, after 'published on its website' insert 'and by notice in the Government Gazette'.
- 3.2. Clause 10(2) of the General Exemption Order is **revoked**.
- 3.3. In clause 18(1) of the General Exemption Order, after 'published on its website' insert 'and by notice in the Government Gazette'.
- 3.4. Clause 18(2) of the General Exemption Order is **revoked**.
- 3.5. After clause 25 of the General Exemption Order, insert:

'PART 4A PRICE FORMULATION FUNCTION

25A. Price formulation

- (1) Pursuant to section 17(2)(j) of the Act, the following functions are conferred on the Essential Services Commission:
 - (a) formulating the maximum price under clause 10(1) of this Order for the purposes of Part 2 of this Order; and
 - (b) formulating the maximum price under clause 18(1) of this Order for the purposes of Part 4 of this Order.
- (2) In formulating a maximum price under clause 25A(1)(a) or (b), the Essential Services Commission:
 - (a) must have regard to commercial market data; and
 - (b) may have regard to any other matter the Essential Services Commission considers relevant.
- (3) A maximum price formulated by the Essential Services Commission takes effect on:
 - (a) the date which is 14 days from the date that notice of the maximum price is published in the Government Gazette pursuant to clause 10(1) or 18(1) (as applicable); or
 - (b) such later date as may be specified in the notice.'
- 3.6. For clause 27 of the General Exemption Order, substitute:

'27. Pricing rule

- (1) Despite clauses 10 and 18, until the Essential Services Commission formulates a maximum price under clause 25A in respect of a particular category of exemption or customer, the price, or range of prices, at which the exempt person may sell or supply electricity (and services related to the provision of electricity) to that customer must not be more

than the tariff that would have applied to the customer had the customer purchased the electricity and related services:

- (a) on or immediately prior to 27 May 2019;
 - (b) from the licensee who, on 27 May 2019, was the local retailer for electricity supplied in the electricity distribution area in which the supply point for the supply of electricity to the customer is located (*relevant licensee*); and
 - (c) pursuant to the licensee standing offer determined by that relevant licensee under section 35(1) of the Act and published in Government Gazette No. S 553 on 30 November 2018.
- (2) In this clause, *local retailer* means:
- (a) AGL Sales Pty Limited (ABN 88 090 538 337) where the supply point for the supply of electricity to the customer is located in the area in which Jemena Electricity Networks (Vic.) Ltd (ABN 82 064 651 083) was licensed to distribute electricity on 27 May 2019;
 - (b) Origin Energy Electricity Limited (ACN 071 052 287) where the supply point for the supply of electricity to the customer is located in the area in which Citipower Pty Ltd (ACN 064 651 056) (previously trading as Citipower Pty) was licensed to distribute electricity on 27 May 2019;
 - (c) EnergyAustralia Pty Ltd (ABN 99 086 014 968) (previously trading as TRUenergy Pty Ltd) where the supply point for the supply of electricity to the customer is located in the area in which AusNet Electricity Services Pty Ltd (ABN 91 064 651 118) (previously trading as SPI Electricity Pty Ltd) was licensed to distribute electricity on 27 May 2019;
 - (d) Origin Energy Electricity Limited (ACN 071 052 287) where the supply point for the supply of electricity to the customer is located in the area in which Powercor Australia Ltd (ACN 064 651 109) was licensed to distribute electricity on 27 May 2019; or
 - (e) AGL Sales Pty Limited (ABN 88 090 538 337) where the supply point for the supply of electricity to the customer is located in the area in which United Energy Distribution Pty Limited (ACN 064 651 029) was licensed to distribute electricity on 27 May 2019.'

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 C: Network tariffs in the cost stack

Table C.1: Single network tariff categories

Distribution zone	Domestic tariff	Small business tariff
AusNet Services	Small residential single rate, NEE11	Small business single rate, NEE12
CitiPower	Residential single rate, C1R	Non-residential single rate, C1G
Jemena	Single rate, A100/F100 general purpose	Small business, A200/F200
Powercor	Residential single rate, D1	Non-residential single rate, ND1
United Energy	Low voltage small 1 rate, LVS1R	Low voltage medium 1 rate, LVM1R

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

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

Table C.3: Controlled load network tariff categories

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

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

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

Appendix D: Calculation of the cost stack

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

Wholesale electricity costs

We engaged Frontier Economics to estimate wholesale electricity costs for 2023–24 using the method described in the chapter on cost components. This methodology produces an estimate based on a 12-month trade weighted average of future contract prices, assuming hedging strategies that minimise the level of risk and an adjustment for volatility.

These costs vary across Victoria as a result of different customer load profiles in each distribution zone. Financial year 2023-24 estimates of the wholesale electricity price and volatility adjustment for each zone are displayed in table D.1.

Table D.1: Wholesale electricity forecasts for 2023–24 (\$/MWh, nominal, GST exclusive)

Distribution zone	Domestic		Small business	
	Wholesale price	Volatility adjustment	Wholesale price	Volatility adjustment
AusNet Services	\$160.58	\$0.43	\$130.16	\$0.46
CitiPower	\$146.40	\$0.36	\$128.35	\$0.49
Jemena	\$160.86	\$0.42	\$131.53	\$0.54
Powercor	\$158.29	\$0.39	\$126.71	\$0.45
United Energy	\$158.96	\$0.38	\$131.87	\$0.58

Source: Frontier Economics, *Wholesale electricity costs for 2023–24: A draft report for the Essential Services Commission*, February 2023.

Network losses

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

We calculated the loss factors based on the 2022-23 distribution loss factors and the preliminary 2023-24 marginal loss factors published by Australia Energy Market Operator (see table D.2).¹³⁰

Table D.2: Network losses for 2023–24

Distribution zone	Distribution loss factor (DLF)	Marginal loss factor (MLF)	Total loss factor
AusNet Services	1.0768	1.0034	8.05%
CitiPower	1.0488	0.9973	4.60%
Jemena	1.0379	0.9994	3.73%
Powercor	1.0776	0.9987	7.62%
United Energy	1.0471	0.9963	4.32%

Source: Australian Energy Market Operator, Distribution Loss Factors 2022–23 and Preliminary Marginal Loss Factors 2023–24

Network costs

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

Tables D.3 and D.4 show the indicative flat network tariffs from the annual pricing proposals of Victorian network business for the period 1 July 2023 to 30 June 2024 (adjusted for inflation). We will update these tariffs with the approved tariffs when we make our final decision.

Table D.3 Domestic electricity network charges, flat tariff, 2023–24 (GST exclusive)

Distribution zone	Daily charge (\$ per year)	Variable charge structure	Variable charge (\$ per kWh)	Controlled load (\$ per kWh)
AusNet Services	\$143.57	Block 1 Block 2	\$0.1360 \$0.1468	\$0.0508
CitiPower	\$97.06	Anytime	\$0.0844	\$0.0253
Jemena	\$105.05	Anytime	\$0.0888	\$0.0371
Powercor	\$150.94	Anytime	\$0.0937	\$0.0271
United Energy	\$96.78	Anytime	\$0.0885	\$0.0250

¹³⁰ Australian Energy Market Operator, Distribution Loss Factors for the 2022-23 Financial Year, November 2022, p. 12; CitiPower, Powercor & United Energy, response to Distribution data: solar export and transmission lines, April 2022; AusNet, response to request on AusNet Services data - solar export and transmission lines, April 2022; Australian Energy Market Operator, Preliminary Marginal Loss Factors 2023–24 Financial Year, December 2022, pp. 26-28.

Source: Victorian distribution businesses' Australian Energy Regulator approved 2022–23 pricing proposals, Australian Bureau of Statistics (Dec-quarter-2022), [Consumer Price Index, Australia](#), ABS Website, accessed 6 March 2023.

Table D.4 Small business electricity network charges, flat tariff, 2023–24 (GST exclusive)

Distribution zone	Daily charge (\$ per year)	Variable charge structure	Variable charge (\$ per kWh)
AusNet Services	\$143.57	Block 1 Block 2	\$0.1934 \$0.2157
CitiPower	\$172.55	Anytime	\$0.0915
Jemena	\$150.55	Anytime	\$0.1189
Powercor	\$194.08	Anytime	\$0.1069
United Energy	\$145.19	Anytime	\$0.0975

Source: Victorian distribution businesses' Australian Energy Regulator approved 2022–23 pricing proposals, Australian Bureau of Statistics (Dec-quarter-2022), [Consumer Price Index, Australia](#), ABS Website, accessed 6 March 2023.

Tables D.5 and D.6 show the indicative two-period network tariffs from the annual pricing proposals of Victorian network businesses for the period 1 July 2023 to 30 June 2023. We adjusted these tariffs for the consumer price index for the purposes of our draft decision. We will use the AER approved tariffs in our final decision.

Table D.5 Domestic electricity network charges, two-period time of use network tariffs, 2023–24 (GST exclusive)

Distribution zone	Daily charge (\$ per year)	Peak variable charge (\$ per kWh)	Off-peak Variable charge (\$ per kWh)	Controlled load (\$ per kWh)
AusNet Services	\$143.57	\$0.2507	\$0.0521	\$0.0508
CitiPower	\$97.06	\$0.1677	\$0.0418	\$0.0253
Jemena	\$105.05	\$0.1465	\$0.0423	\$0.0371
Powercor	\$150.94	\$0.1859	\$0.0466	\$0.0271
United Energy	\$96.78	\$0.1732	\$0.0432	\$0.0250

Source: Victorian distribution businesses' Australian Energy Regulator approved 2022–23 pricing proposals, Australian Bureau of Statistics (Dec-quarter-2022), [Consumer Price Index, Australia](#), ABS Website, accessed 6 March 2023.

Table D.6 Small business electricity network charges, two-period time of use network tariffs 2023–24 (GST exclusive)

Distribution zone	Daily charge (\$ per year)	Peak variable charge (\$ per kWh)	Off-peak variable charge (\$ per kWh)
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AusNet Services	\$143.57	\$0.2067	\$0.0505
CitiPower	\$172.55	\$0.1520	\$0.0338
Jemena	\$267.35	\$0.1543	\$0.0321
Powercor	\$194.08	\$0.1861	\$0.0413
United Energy	\$145.19	\$0.1599	\$0.0355

Source: Victorian distribution businesses' Australian Energy Regulator approved 2022–23 pricing proposals, Australian Bureau of Statistics (Dec-quarter-2022), [Consumer Price Index, Australia](#), ABS Website, accessed 6 March 2023.

Table D.7 shows a mass market weighted average of the Australian Energy Regulator approved network metering charges from 1 July 2022 to 30 June 2023, adjusted for changes in the consumer price index, used in the draft decision. Since indicative metering charges were not available, we used the charges from the Australian Energy Regulator approved pricing proposals for 2022–23. We will update these with the Australian Energy Regulator approved charges when we make our final decision.

Table D.7 Network metering charges, 2022–23 (GST exclusive)

Distribution business	Annual metering charge (\$ per customer)
AusNet Services	\$79.46
CitiPower	\$71.00
Jemena	\$69.78
Powercor	\$67.02
United Energy	\$47.02

Source: Victorian distribution businesses' Australian Energy Regulator approved 2022–23 pricing proposals, Australian Bureau of Statistics (Dec-quarter-2022), [Consumer Price Index, Australia](#), ABS Website, accessed 6 March 2023.

Environmental scheme costs

Large-scale Renewable Energy Target costs

Under the Large-scale Renewable Energy Target scheme, the Clean Energy Regulator has set the 2023 renewable power percentage (18.96 per cent). We calculate the 12-month average of forward market prices for financial year 2023–24 large-scale generation certificates.¹³¹ We include a true-up to account for the difference between the 2022 renewable power percentage used in the 2022–23 Default Offer and the midpoint renewable power percentage between 2022 and 2023.

¹³¹ Frontier Economics, Wholesale electricity costs for 2023–24: A draft report for the Essential Services Commission, February 2023, pp. 46–47.

Small-scale Renewable Energy Scheme costs

The federal Clean Energy Regulator has published the binding small-scale technology percentage for 2023. We used the mid-point between the 2023 binding and 2024 non-binding small-scale technology percentage to calculate the liability for this decision.¹³²

Historically, spot prices for certificates under the Small-scale Renewable Energy Scheme have been at or close to the clearing house price of \$40. For this reason, the price per certificate is assumed to be \$40. We include a true-up to account for the difference in the non-binding and binding 2023 small-scale technology percentage, allowing an adjustment for the difference between the 2022–23 Default Offer and this draft decision.

Victorian Energy Upgrades costs

For the cost of complying with the Victorian Energy Upgrades program, we use the relevant greenhouse gas reduction rate for electricity for the calendar year 2023 (0.1631).¹³³ The cost of Victorian energy efficiency certificates under the Victorian Energy Upgrades program is estimated from the trade-weighted average of 12-month historic spot market prices. Based on the information available on 10 January 2023, we estimated an average price of \$69 per certificate for the draft decision. Our estimate of the per megawatt hour Victorian Energy Upgrade Costs for the draft decision is \$11.25, which is lower than the estimate used in the 2022–23 Victorian Default Offer of \$11.86.

Feed-in Tariff (social cost of carbon)

For the draft decision, the impact of the feed-in tariff on retailer costs is based on total small-scale renewable exports in the most recently available financial year¹³⁴ multiplied by the social cost of carbon (2.5 cents per kWh for 2023–24). The resulting figure is divided by the total average domestic and small business customer numbers in the same period.

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

Environmental scheme	Certificate price, \$/MWh	Scheme liability, %	Cost, \$/MWh
Large-scale Renewable Energy Target	\$54.66	18.96	\$10.36

¹³² Clean Energy Regulator, The small-scale technology percentage, accessed 6 February 2023, [The small-scale technology percentage \(cleanenergyregulator.gov.au\)](https://www.cleanenergyregulator.gov.au/).

¹³³ Essential Services Commission, Energy retailers in the VEU program: Determining liability, <https://www.esc.vic.gov.au/victorian-energy-upgrades-program/participating-veu-program/energy-retailers-veu-program#toc--determining-liability>, accessed 23 February 2023.

¹³⁴ Total solar exports from 1 July 2021 to 30 June 2022.

Small-scale Renewable Energy Scheme	\$40.00	17.14	\$6.86
Victorian Energy Upgrades	\$69	16.31	\$11.25
Feed-in Tariff (social cost of carbon)			\$16.80/customer
Small-scale Renewable Energy Scheme true up adjustment (GST inclusive)			-\$1.49
Large-scale Renewable Energy Target true up adjustment (GST inclusive)			\$0.07

Source: ESC analysis and Frontier Economics, *Wholesale electricity costs for 2023–24: A draft report for the Essential Services Commission*, February 2023, pp. 46–47.

Retail operating costs

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

Retail costs

Our updated benchmark is \$134.54 excluding GST for retail operating costs.

Customer acquisition and retention costs

Our benchmark for the draft decision is \$43.30 excluding GST for customer acquisition and retention costs.

Retail margin

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

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

Retail costs and margin	Annual benchmark
Retail operating costs	\$134.54
Customer acquisition and retention costs	\$43.30
Retail margin	5.7%

Other costs

Retailers incur other costs through fees for market operations and ancillary services. Information about these costs has been gathered primarily from the Australian Energy Market Operator's

Budget and Fees and compensation updates.¹³⁵ The estimate of our licence fee is a market-wide average based on the approved fees for the year 2022–23, which is the latest available information. We adopted a forecast of ancillary charges based on analysis of the past 12 months of ancillary service cost data.

Table D.10: Other costs (GST exclusive)

Charge	Rate
Essential Services Commission licence fee	\$2.23/customer
Australian Energy Market Operator fees	
National Electricity Market fees	\$0.79/MWh
Full retail contestability	\$1.37/customer
National Transmission Planner	\$0.00/MWh
IT Upgrade and Five-minute and global settlement compliance fees	\$0.22/MWh
Distributed energy resources integration program fees	\$0.02/MWh
Energy Consumers Australia	\$0.60/customer
Ancillary services	\$0.42/MWh
Reliability and Emergency Reserve Trader	\$0.00/customer
Market suspension - usage	\$0.70/MWh
Directions - usage	\$0.09/MWh
Administered price cap - usage	\$0.00/MWh
Total per MWh:	\$2.25/MWh
Total per customer:	\$4.20/customer¹³⁶

¹³⁵ Australian Energy Market Operator, [2022-23 AEMO Budget and Fees](#), May 2022, p. 7 and pp 13–16 and p. 33. [Australian Energy Market Operator June 2022 NEM Events: Compensation Update \(6 January 2023\)](#), accessed 16 January 2023.

¹³⁶ Values in the table do not sum to exact total due to rounding.

Appendix E: How we assessed the Victorian Default Offer

Appendix A sets out the requirements for and matters we must have regard to in making a Victorian Default Offer price determination. This appendix summarises how we considered these matters.

Our approach to this review

In coming to our draft decision on the 2023–24 Victorian Default Offer, we have built on our 2022–23 price determination, assessed developments in the retail electricity market (since we made our last final decision) and analysed the costs of providing retail electricity services, among other matters. We consider this approach and methodology best meets our legislative objectives and requirements.

Our review has used largely the same methodology as we did in our 2022–23 price determination. As part of this review, the estimates included in the cost stack were updated to reflect changes in the market and new data that is now available. Our approach helped us establish the cost estimates that best meet our legislative objectives, including our obligation that the price determination be based on the efficient costs of the sale of electricity by a retailer, in light of the matters we must have regard to (see appendix A).

We analysed the efficient costs of electricity retailers

Through issuing notices under our compulsory information gathering powers, we have collected cost data from electricity retailers. This information allowed us to understand the types of costs electricity retailers incur and elements of the efficient costs of supplying electricity to customers. The analysis of the cost data has informed our assessment of costs in our draft decision for the 2023–24 Victorian Default Offer.

We sought advice from independent consultants on forecasting retailers' wholesale electricity costs and of retailers' costs of complying with environmental programs for 2023–24.

Our approach and methodology include these elements to estimate the efficient costs of the sale of electricity by a retailer:¹³⁷

¹³⁷ Clause 12(4) of the pricing order.

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

Some elements of the cost-stack are estimated using market data such as wholesale electricity purchase costs. We updated estimates of these elements in our draft decision to account for any changes in market data that occurred since our last decision. The data provided by retailers was used to set the retail operating cost benchmark, as a cross check of our cost stack and allowed us to compare the cost stack elements across different segments of the retail market. We also used findings from other regulators (such as decisions on the retail operating margin) in assessing the cost stack.

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

We considered changes to the capital expenditure of retailers

In considering efficient costs, we may consider any other costs additional to those identified in the pricing order, or other matters or things we, in the exercise of our discretion, consider appropriate or relevant.¹³⁸

Among other things, our review has taken into consideration the treatment of the capital expenditure due to regulatory changes in the market.

At a high level, our analysis of cost data provided to us by retailers obtained through our formal information gathering powers following our draft decision, suggests the benchmark we adopted provides a reasonable opportunity for a retailer to recover efficient costs, after taking into account the additional cost claims by retailers. In considering this information we have had regard to our

¹³⁸ Clause 12(4)(f) of the pricing order.

statutory objectives, including the financial viability of the retail energy market and promoting full retail competition.

We considered our approach to the compliant maximum annual bill

Our price determination framework also includes a compliant maximum annual bill. While our first determination was required to use a maximum bill to regulate non-flat standing offer tariffs, the requirements for subsequent decisions (including this one) allow us to decide on the best approach. In this decision we continue to include a two-period time of use that will cover most non-flat standing offers. We also continued to include a compliant maximum annual bill so that all standing offer customers can enjoy the protection of the Victorian Default Offer.

In taking this approach we had regard to the objective of the Victorian Default Offer to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.¹³⁹ We also consider this arrangement provides a framework that does not impose unreasonable costs on retailers.¹⁴⁰ As with other elements of our methodology, we also had regard to the approaches adopted by other regulators including the Australian Energy Regulator's Default Market Offer.¹⁴¹

Our assessment approach helps us meet our legislative requirements

Our assessment approach helps us meet our objectives

In deciding our approach and methodology for setting the Victorian Default Offer, and in making the Victorian Default Offer price determination 2023-24 our objectives are to:

- promote the long-term interests of Victorian consumers, having regard to the price, quality and reliability of essential services¹⁴²
- promote protections for customers, promote the development of full retail competition and to adopt a consistent regulatory approach between the electricity and gas industries (noting there is currently no framework for the regulation of prices for retail gas services).¹⁴³

¹³⁹ Electricity Industry Act 2000, s 10(c).

¹⁴⁰ Essential Services Commission Act 2001, s 8A(1)(e).

¹⁴¹ Essential Services Commission Act 2001s, s 8A(1)(f).

¹⁴² Essential Services Commission Act 2001, s8 and s 8A.

¹⁴³ Electricity Industry Act 2000, s 10.

- provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.¹⁴⁴

Having regard to the relevant matters under section 8A and section 33 of the ESC Act

In seeking to achieve our objectives in making our determination, we must have regard to a number of matters to the extent that they are relevant.¹⁴⁵ We have had regard to all of these matters in coming to our draft decision.

Efficiency

Efficiency is an important consideration for our decision.¹⁴⁶ Our approach helped us establish the tariffs that reflect the efficient costs of the sale of electricity by a retailer, including a retail operating margin.¹⁴⁷ Our review used largely the same approach as our 2022–23 price determination.

Financial viability

A related matter is the consideration of long-term incentives for investment and financial viability.¹⁴⁸ As our decision on the Victorian Default Offer reflects our estimates of efficient costs we consider that it helps promote the financial viability of the industry.

Competition within the industry

In relation to the scope for competition in the market we note setting prices at efficient costs is consistent with competition and does not preclude innovation that may lead to customers accepting market contracts that offer a better deal for them than the Victorian Default Offer. Likewise, it does not prevent retailers, who can lower their costs, from attracting customers by making cheaper market offers available.¹⁴⁹

The relevant legislation applying to the industry

We considered other legislation that affects the efficient costs of a retailer.¹⁵⁰ Among other things, we considered costs associated with regulatory requirements on retailers (such as the Large-scale Renewable Energy Target, Small-scale Renewable Energy Scheme, Victorian Energy Upgrades,

¹⁴⁴ Clauses 3 and 12(2) of the pricing order. Also consistent with section 10(c), Electricity Industry Act.

¹⁴⁵ Essential Services Commission Act 2001, ss 8A and 33(3).

¹⁴⁶ Essential Services Commission Act 2001, ss 8A(1)(a) and 33(3)(b).

¹⁴⁷ Clause 12(4)(e) of the pricing order.

¹⁴⁸ Essential Services Commission Act 2001, s 8A(1)(b).

¹⁴⁹ Essential Services Commission Act 2001, s 8A(1)(c).

¹⁵⁰ Essential Services Commission Act 2001, s 8A(1)(d).

five-minute settlements and consumer data right). We also note that our benchmarks of retailer operating costs, customer acquisition and retention costs and retail operating margin reflect the costs and margins of Victorian retailers complying with regulatory and legislative requirements.

The benefits and costs of regulation

The Victorian Default Offer was introduced as part of an independent review of the gas and electricity markets in Victoria. The Victorian Default Offer is a simple, trusted and reasonably priced electricity option that safeguards customers unable to engage in the electricity retail market.¹⁵¹ In formulating the Victorian Default Offer we are not required to revisit the costs and benefits of implementing the Victorian Default Offer.¹⁵²

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

We looked at regulation of retail electricity prices on a national basis and considered relevant benchmarks from other jurisdictions. In considering benchmarks from other jurisdictions we also had regard to the different policy intent of the relevant legislation.¹⁵³

The particular circumstances of the regulated industry

As part of this review, the estimates included in the cost stack have been updated to reflect changes in the market and new data that is now available.¹⁵⁴ We also had regard to actual cost data from retailers. We also considered the broader economic environment including the impact of wholesale electricity market intervention compensation and increased debt finance costs on retailers.

Accounting for trade-offs between costs and service standards

We must ensure that the determination takes into account and clearly articulates any trade-offs between costs and service standards.¹⁵⁵ In terms of quality and reliability of services, retailers are required to offer the Victorian Default Offer under the regulated terms and conditions for standard

¹⁵¹ The development of the Victorian Default Offer stemmed from the Independent Review into the Electricity and Gas Retail Markets in Victoria. The final report from the Independent Review recommended a range of regulatory responses were required to protect the long-term interests of consumers. See Independent Review into the Electricity and Gas Retail Markets in Victoria: Final Report, August 2017, p. 52.

¹⁵² Under clause 12(11) of the pricing order, section 33(4)(a) of the Essential Services Commission Act 2001 does not apply to a Victorian Default Offer price determination.

¹⁵³ Essential Services Commission Act 2001, ss 8A(1)(f) and 33(3)(d).

¹⁵⁴ Essential Services Commission Act 2001, s 8A(1)(e).

¹⁵⁵ Essential Services Commission Act 2001, s 33(4)(b).

retail contracts. We consider the prices provided to retailers under the Victorian Default Offer will be sufficient for retailers to ensure the quality of service experienced by customers to at least continue to meet these regulated terms and conditions.

Other relevant matters under clause 12 of the pricing order

Clause 12 of the pricing order provides for certain further matters we must have regard to when adopting our approach and methodology for making a Victorian Default Offer price determination. We considered these matters in making our final decision. These are the wholesale electricity costs, network costs, environmental costs, retail operating costs, including only modest costs of customer acquisition and retention, retail operating margin, and any other costs, matters or things we consider appropriate or relevant.

The commission has had regard to these matters and they are dealt with in the body of our decision including the cost stack chapter.

Appendix F: Stakeholder submissions on consultation paper

Name of organisation	Date received
Ray Stephens	9 December 2022
Anonymous 1	10 December 2022
Ronald Heard	14 December 2022
Errol Muir	16 December 2022
Candice Miles	24 December 2022
Michael Robert Tierney	16 January 2023
Energy Consumers Australia	19 January 2023
GloBird Energy	24 January 2023
Simply Energy	24 January 2023
Angela Hood	25 January 2023
Energy Locals Pty Ltd	27 January 2023
Consumer Action Law Centre	27 January 2023
Robert Leversha	28 January 2023
Master Electricians Australia	30 January 2023
1st Energy	30 January 2023
Victorian Council of Social Service	30 January 2023
Red Energy Lumo Energy	30 January 2023
Alinta Energy	30 January 2023
Powershop	30 January 2023
AGL	30 January 2023
Momentum	30 January 2023

EnergyAustralia	30 January 2023
Australian Energy Council	30 January 2023
Origin Energy	30 January 2023

Appendix G: Changes to cost benchmarks

Table G.1 shows how our cost stack has changed compared to the 2022–23 Victorian Default Offer.

Table G.1: Changes between 2022–23 Victorian Default Offer final decision and 2023–24 Victorian Default Offer draft decision

Item	2022–23 Victorian Default Offer final decision	2023–24 Victorian Default Offer draft decision
Victorian Default Offer costs		
Wholesale electricity costs	12-month trade weighted contract price is calculated from the daily settlement price for each day in the period.	12-month trade weighted contract price is calculated from the daily settlement price for each day in the period except the date that options contracts are exercised (21 November 2022). Final reading last Friday of April.
Network costs	Australian Energy Regulator's approved network tariffs are treated as pass through costs. Metering costs based on customer weighted average metering costs.	We used indicative network tariffs from the pricing proposals of network businesses adjusted for inflation by the consumer price index. Metering costs based on customer weighted average metering costs based on current metering costs also adjusted for inflation. For the final decision we will use the network costs approved by the Australian Energy Regulator
<i>Environmental costs</i>		
Large-scale Renewable Energy Target	Estimated based on the 2022 default renewable power percentage (calculated using the Clean Energy Regulator's outlined methodology) multiplied by the futures market price for large-scale certificates.	No change in approach but updated with most appropriate data.
Small-scale Renewable Energy Scheme	Estimated based on mid-point	No change in approach but updated small-scale technology

Item	2022–23 Victorian Default Offer final decision	2023–24 Victorian Default Offer draft decision
	<p>of the 2023 non-binding small-scale technology percentage and the 2022 binding small-scale technology percentage, multiplied by the clearing house price.</p> <p>We included an adjustment to account for the discrepancy between the level of the non-binding small-scale technology percentage we used in the 2021 Victorian Default Offer and the binding small-scale technology percentage for 2022.</p>	percentage to reflect the midpoint of the 2023 binding and 2024 non-binding percentages.
Victorian Energy Upgrades	Estimated based on the 2022 greenhouse reduction rate for electricity multiplied by the historic 12-month trade-weighted average price for Victorian energy efficiency certificates.	No change in approach but used 2023 greenhouse reduction rate.
Minimum feed-in tariff (social costs of carbon)	Estimated based on total renewable exports from 1 March 2021 to 28 February 2022 divided by average total domestic and small business customers in the same period, multiplied by the social cost of carbon of 2.5 cents per kWh.	No change in approach but used renewable exports and average total domestic and small-business customers for financial year 2021-22
Retail operating costs	Estimated based on a benchmark set by the Independent Competition and Regulatory Commission in 2017 and adjusted for the change in consumer price index since 2017.	<p>Estimated based on a benchmark set by taking the customer weighted average of retailers' actual operating cost data from financial year 2020-21. This benchmark was adjusted for the change in consumer price index since June 2021.</p> <p>This will be updated to reflect 2021-22 cost data in our final decision.</p>
Customer acquisition and retention costs	Estimated based on cost levels from the Australian Competition and Consumer Commission's retail and electricity pricing	No change in approach

Item	2022–23 Victorian Default Offer final decision	2023–24 Victorian Default Offer draft decision
	inquiry's final report updated for inflation. ¹⁵⁶	
Other costs	Estimated and updated based on the latest available information on the: Australian Energy Market Operator's compensation updates, fees and charges for Distributed Energy Resources Integration Program and five-minute settlement; ancillary fees; reliability and emergency reserve trader costs; and Essential Services Commission licence fees.	Included amounts to reflect known market intervention compensations amounts determined by the Australia Energy Market Operator for directions, suspension pricing (provisional and revision amounts) and administered pricing compensations claims as of 6 January 2023. For final decision will use costs known as of last Friday of April (28 April 2023).
Retail operating margin	Estimated benchmark of 5.7 per cent is based on recent regulatory decisions by Australian regulators.	No change in approach
Other matters		
Tariffs and structure	Flat tariffs Two period time-of use tariffs Compliant maximum annual bill based on two period time-of use tariffs	No change in approach
Regulatory period	12 months	No change in approach
Consultation papers	One at the beginning of each review.	Replace with request for comment papers.

¹⁵⁶ Australian Competition and Consumer Commission, Retail electricity pricing inquiry – Final report, July 2018.

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

Item	2022–23 Victorian Default Offer final decision	2023–24 Victorian Default Offer draft decision
Wholesale electricity costs	\$340	\$665
Network costs	\$527	\$579
Environmental costs	\$138	\$133
Retail operating costs (including acquisition costs)	\$187	\$178
GST	\$127	\$167
Retail operating margin	\$73	\$95
Other costs	\$10	\$14
Total	\$1,403	\$1,829