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30 January 2023

Ms Kate Symons  
Chair  
Essential Services Commission  
Level 8, 570 Bourke Street  
Melbourne VIC 3000

Submitted via email: [VDO@esc.vic.gov.au](mailto:VDO@esc.vic.gov.au)

Dear Ms Symons,

**Re: Consultation - Victorian Default Offer 2023/24**

Red Energy and Lumo Energy (Red and Lumo) are pleased to make this submission to the Essential Services Commission's (the Commission's) consultation paper for the Victorian Default Offer to apply from 1 July 2023.

The Commission will be aware of the very challenging operating environment for retailers, which is expected to persist for some time. This was analysed at length in the Australian Competition and Consumer Commission's (the ACCC's) most recent report to the Treasurer on the state of the NEM. The ACCC noted increased costs, reduced margins, a historically high volume of retailer failures, and the difficulty for many retailers to recover their actual costs under regulated retail pricing.<sup>1</sup>

Within this environment, Red and Lumo strongly recommend the Commission retain a consistent approach for the next VDO. It has used a well established and transparent methodology for each determination to this point and retaining this model for the next VDO would send a signal to retailers about the stability of the regulatory framework, thereby supporting competition.

Therefore, we support the Commission's proposal to continue to use ASX futures contracts and its established methodology to calculate wholesale costs for the next VDO. The Commission should signal and consult on any significant changes to its methodology that it might be considering—such as including additional data sources in the calculation of wholesale costs—well in advance of implementation. This would give stakeholders the opportunity to comment on all implications of any change (and make any adjustments to their operations), allowing the Commission to make a more complete impact assessment.

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<sup>1</sup> Australian Competition and Consumer Commission (2022), *Inquiry into the National Electricity Market - November 2022 report*

The consultation paper also seeks views on whether the Commission should continue to adjust retail costs, including acquisition and retention costs, in line with the Consumer Price Index (CPI), suggesting this could overstate changes in actual costs.

While retail costs are a smaller component of the VDO than wholesale and network costs, our view remains that the Commission should retain a consistent approach for the next determination. The CPI has never been more than a proxy for changes in actual costs but the Commission has used it for every VDO thus far. It may indeed overstate the actual change in costs for some retailers but it is just as likely to understate actual changes for other retailers. This will depend on their individual operations and how they may have changed over the last 12 months in line with the disruption in energy markets, the lingering effects of the pandemic and well documented labour shortages. Furthermore, there is no obvious alternative that we consider to better reflect cost movements across the full range of retailers over the last 12 months, or indeed for any 12 month VDO determination period.

As a further point, retaining the CPI is consistent with the principles outlined in the consultation paper—namely, efficiency, accuracy, transparency, simplicity and stability.

### **Consumer Data Right**

The Commission will be aware that the Tier 1 retailers were obligated to comply with the Consumer Data Right (CDR) for small consumers and for 'simple' requests from November 2022 (and complex requests from May 2023), while other retailers must comply from November 2023. The CDR is a significant regulatory initiative and the cost of implementation and ongoing compliance will be material. As such, they should be included in the VDO. Red and Lumo can provide confidential estimates of the costs of implementation and ongoing compliance but at this stage, the Tier 1 retailers will have more a complete view of the actual costs.

### **Generator compensation**

The consultation paper discusses the various market interventions during 2022 and the subsequent calculation of generator compensation by AEMO and the Australian Energy Market Commission (AEMC) respectively. At this stage, it seems likely that compensation costs that the AEMO is calculating will be known by the time of the final determination and we support their inclusion in the next VDO. As the Commission notes, these are material costs that retailers cannot avoid through efficiency gains so they should be included in the cost stack.

On the other hand, there is considerable uncertainty about both the materiality and the timing of the compensation that the AEMC is calculating. The outcome of these calculations remains

highly uncertain but retailers will potentially have to carry a significant cost in 2023/24 if it is not accounted for in the next VDO.

Red and Lumo encourage the Commission to liaise with the AEMC to better understand the potential outcome and to allow it to make a more informed decision about whether this cost can be included in the VDO in some way. In the current environment, this cost may be significant and create challenges with liquidity, particularly for smaller retailers, and the Commission can then consider how to mitigate this risk. One option might be to include a higher retail allowance.

Alternatively, it could include an amount in the final determination that is the best estimate available to it at that time and then adjust the next VDO in the next determination period if the difference between the estimate and actual amount is material (i.e. commensurate to a true-up mechanism).

### **About Red and Lumo**

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in New South Wales, Queensland, South Australia, Victoria and in the ACT to over 1.2 million customers.

We thank the Commission for the opportunity to comment on its consultation paper. Should you wish to discuss aspects of this submission or have any further enquiries, please contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read "G Hargreaves".

**Geoff Hargreaves**  
Manager - Regulatory Affairs  
**Red Energy Pty Ltd**  
**Lumo Energy (Australia) Pty Ltd**