

19 April 2024

Essential Services Commission

To Whom It May Concern

Victorian Default Offer 2024-25: Draft Decision Paper

Energy Locals Pty Ltd (ACN 606 408 879) welcomes the opportunity to provide a submission to the Essential Services Commission (ESC) in relation to the Victorian Default Offer (VDO) Draft Decision Paper (Draft Decision).

Energy Locals is generally supportive of the VDO Draft Decision. We support the approach of keeping the methodology consistent with the 2023-24 VDO as we appreciate the certainty and forward planning that the consistent approach provides. However, we do have concerns that the retail operating margin has remained at 5.3%, which leaves little room to further manage cost-based risk. In this regard, there are also several aspects which we believe require closer consideration by the ESC before the final decision. In particular, we urge the ESC to carefully calculate rising environmental scheme costs and to capture the increasing costs of Victorian Energy Efficiency Certificates (VEECs). We also encourage the ESC to consider smaller retailers when calculating retail operating costs.

1. Background – overview of Energy Locals

Energy Locals is an authorised electricity and gas retailer that supports customers directly as well as via partnerships with newcomers to the energy retail sector, such as RACV, Indigo Power, Cooperative Power, Tesla, and others. A retail gas offer has not yet been launched.

2. Wholesale electricity costs

With regard to wholesale costs, we appreciate that the ESC has maintained the methodology used in previous years. This is important as it provides retailers with consistency and predictability for planning purposes. Energy Locals agrees with previous comments made to the ESC by other retailers supporting the wholesale benchmark, provided that the ESC continue to monitor changes in demand and the types of contracts used by retailers.¹

3. Network costs

Energy Locals is supportive of the ESC's approach to the network costs. However, we consider that the VDO final decision must be conditional on the Australian Energy Regulator (AER) having

¹ Essential Services Commission 2024, *Victorian Default Offer 2024–25: Draft Decision Paper: Draft Decision Paper*, 19 March, p.12

approved tariffs for 2024-25. In the event that that AER approved network prices are not available by the ESC's indicative timeline of 24 May 2024, the final decision should be deferred.

4. Environmental costs

Energy Locals supports the approach of considering the following environmental costs incurred by retailers in relation to the following programs:

- Large-scale Renewable Energy Target;
- Small-scale Renewable Energy Scheme;
- Victorian Energy Upgrades (VEU) program; and
- the social cost of carbon applied within the minimum feed-in tariff.

However, given the VEU scheme costs often fluctuate and have risen significantly in recent months we recommend that the ESC adjust the trade weighted approach to avoid underestimations. Energy Locals also encourages the ESC to incorporate a true-up adjustment for any cost differentials in scheme costs.

a) *VEU scheme costs*

Energy Locals is concerned by the rising costs of Victorian Energy Efficiency Certificates (VEECs). On many occasions, we have expressed to the ESC our concern that there are fundamental issues with the VEU scheme.

We understand that for the VDO, the ESC has used the most recent 12-month trade weight average spot price for VEECs multiplied by the 2024 greenhouse gas reduction rate for electricity. Based on the information available on 17 January 2024, the ESC has estimated an average price of \$77.15 per certificate for the Draft Decision. However, we consider these estimates are not an accurate representation of the current market. We are concerned that the prices are heavily manipulated, and, to date, have been unable to find a counterparty that would offer a spot/forward contract near the price of \$77.

The scarcity of certificates has resulted in higher prices and these higher prices may not be reflected in the trade weighted average. Similarly, we are concerned about the volatility/unpredictability of the VEU. In this regard, the risk of volatility of the VEECs market may be further increased as a result of the telemarketing and doorknocking bans for the VEU. It is not yet clear what implications this may have on the availability of VEECs.

b) *Small-scale renewable technology certificates (STCs)*

We understand that the ESC has used the Clean Energy Regulator's 2024 non-binding liability percentage for the Draft Decision. We support the ESC's proposed approach of performing a true-up in the final decision once the 2024 liability percentage is known.

5. Retail operating costs

As raised in our submission last year, by taking a weighted average approach to determining retailers' actual costs, the VDO is likely to be suitable for larger, tier 1 retailers who have the ability to operate at scale. This, however, does not reflect the actual costs of smaller retailers and it is

the smaller retailers that bring substantial additional competition to the market, which in turn lowers prices for customers of tier 1 retailers.

To this point, we agree with the concern raised by Simply Energy that the customer-weighted average retail operating cost benchmark does not accurately reflect retailer's efficient costs and introduces a bias in the estimate towards the operating costs of the three major retailers.² We also agree with the Australian Energy Council's suggestion that the ESC should continue to monitor the retail operating costs reasonably expected for a start-up and a prudent tier 2 retailer for comparison against the customer-weighted cost estimate.³

We appreciate that the ESC has noted that there are several retailers of different sizes that have retail operating costs below the retail operating cost benchmark and that the ESC will continue to monitor where the retailers' costs sit relative to the benchmark. This continuation is important to preserve the competitive nature of the Victorian market.

Another key consideration which does not appear to be factored into the ESC's methodology for retail operating costs is the requirement on retailers to fund the cashflow associated with customer concessions. While concessions are immediately applied to customer bills, it can be a lengthy delay before retailers can recover these costs. Given such payments are quite often delayed significantly, retailers are burdened with carrying the cost of this debt and fund the shortfall in cash. At the time of writing, Energy Locals is owed well over ██████████ in Victoria.

6. Retail operating margin

The ESC has proposed to maintain the retail operating margin at 5.3% and to continue to use the retail operating margin benchmark used in the last VDO. As a consequence, the dollar value of the retail operating margin in the domestic cost stack will decrease by 7 per cent (on average across Victoria's five distribution zones) relative to the amount in the 2023–24 VDO. Energy Locals is concerned by this reduction.

By setting the retail operating margin at just 5.3% retailers may face increasing risk of unprofitability. The ESC must carefully consider this, particularly, in light of the number of smaller retailers collapsing and leaving the market in recent years.⁴

We note that the ESC has outlined, based on Victorian Energy Compare Data, that since 2020 more than three quarters of market offers have been below the VDO.⁵ If the ESC is intending to suggest that this trend supports a low retail margin, Energy Locals urges the ESC to consider the objectives of the VDO and the requirements to use it as a reference price to enable customers to compare market offers. For a retailer to be competitive and given the requirement to advertise prices in comparison to the VDO, retailers are forced to keep prices low or close to the VDO. This places strong cost pressures on smaller retailers.

² Simply Energy, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

³ Australian Energy Council, submission to the Essential Services Commission '2024-25 Victorian Default Offer: Request for Comment' December 2023.

⁴ Macdonald Smith, Angela "Energy crisis claims next retailer", AFR, 21 June 2022 [online] available at <<https://www.afr.com/companies/energy/energy-crisis-claims-next-retailer-20220621-p5aveo>>

See also, Hannam, Peter "More electricity retailers likely to fail, resulting in less competition and higher prices" The Guardian, 23 June 2022 [online] available at <<https://www.theguardian.com/australia-news/2022/jun/23/more-electricity-retailers-will-likely-fail-over-the-next-year-resulting-in-less-competition-and-higher-prices>>

⁵ Essential Services Commission 2024, 'Victorian Default Offer 2024–25: Draft Decision Paper', 19 March, p.37 and 39

7. Summary of Energy Locals position

Energy Locals is supportive of the ESC maintaining the same methodology as previous years as we appreciate the certainty and transparency that this provides. However, we are concerned that the ESC has underestimated some costs, notably the VEU scheme costs. We also consider that the ESC has favoured Tier 1 retailers in its calculation of retail costs and urges the ESC to continue to monitor the retail operating costs reasonably expected for a smaller retailer. Energy Locals would welcome an increase to the retail operating margin in the final decision that reflects the inflationary pressures facing all service providers that employ a 100% Australian-based team.

Energy Locals would like to take this opportunity to thank the ESC for the opportunity to consult on this Draft Decision. We are very happy to discuss any aspect of this submission with the ESC team.

Yours faithfully,



Adrian Merrick
Chief Executive Officer
Energy Locals Pty Ltd

