16 April 2025

Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC
3000

RE: Victorian Default Offer 2025-26: Draft Decision Paper

About Powershop and Shell Energy in Australia

Shell Energy is an energy solutions business and renewables and battery energy storage system developer in Australia.

As the one of the largest electricity providers to commercial and industrial businesses in Australia[1], Shell Energy offers integrated solutions and market-leading[2] customer satisfaction, innovation across a portfolio of electricity, gas, environmental products and energy productivity. Our residential energy retailing business Powershop, acquired in 2022, serves households and small business customers in Australia.

Our generation assets include 662 megawatts of gas-fired peaking power stations in Western Australia and Queensland, supporting the transition to renewables, and the 120-megawatt Gangarri solar energy development in Queensland. Shell Energy also operates the 60MW Riverina Storage System 1 in NSW, as well as the 200MW Rangebank Storage System and 370MW Koorangie Storage System both located in Victoria.

Shell Energy Australia Pty Ltd and its subsidiaries trade as Shell Energy, while Powershop Australia Pty Ltd trades as Powershop. Further information about Shell Energy and our operations can be found on our website here.

General Comments

Powershop recognises the cost-of-living pressures facing many energy consumers in Victoria and acknowledges that supporting vulnerable customers is important part of a retailer's role. We also support the ESC's commitment to upholding the VDO's dual function as a safety net for consumers that remain on standing offer and as a comparison price that helps consumers choose the most competitive market offer to serve their needs. To ensure the VDO functions as expected and is in the in the long-term interests of consumers, it is essential that the cost stack genuinely reflects the cost of supplying energy. It is integral to the long-term sustainability of the retail market that the ESC does not turn the VDO into a blunt instrument to artificially lower energy tariffs in Victoria.

Our submission focusses on the following key issues:

- The retail cost and efficient margin calculations;
- The treatment of solar imports in the ESC's modelling; and
- Environmental costs inclusion and importance.

Retail costs, margins and competitive market offers

A key benefit of a healthy energy market is the availability of competitive market offers and incentives for investment in processes, systems and efficiencies that drive down the cost to serve and provide new and better services for consumers. Consistent accommodation of accurate retail cost calculations and reasonable retail margin allowances in the VDO are essential to strengthen retail competition, providing sufficient incentives to improve and evolve services and incentivising new retailers to enter and existing ones to stay, benefiting Victorian consumers. This is crucial in the context of the ongoing energy transition, which is decentralising energy flows and requires enhanced consumer energy literacy and engagement. Augmenting and in some cases rebuilding crucial parts of our energy system requires significant investment in networks and retailers' systems, which carry additional risk. It is therefore essential that the regulator continues to support the substantial investment required to accommodate our evolving energy system when determining the VDO.

Powershop notes the ESC's analysis of EBITDA to determine the margin retailers are producing in Victoria. The ESC may need to consider that it is unlikely that all retail costs are recognised as operating expenses – with investments in systems and software often capitalised and recognised through depreciation and amortisation. Therefore, the analysis should factor in additional room for capital expenditure that is recovered over multiple years.

The difference between the regulated retailer margin (5.3% in the year the data was taken) and actual EBITDA figures provided in the draft decision underscores the importance of precisely allocating retailer costs and margin. Retailers face growing pressure to manage the rising tide of wholesale, network and retail (including compliance) risks. Managing these risks requires retailers to invest heavily in their businesses (including personnel, IT systems, more sophisticated hedging products), which drives costs up in the short term. The ESC acknowledges that the energy transition is contributing to this growing risk and notes that there are financial instruments and strategies that can be utilised.[1] The higher premiums payable for these financial products are adding to retailer wholesale costs.

Theoretical retail margins are what remain after retail, wholesale, environmental and network costs incurred throughout the year are taken out. While the VDO provides fixed averages forecast for these costs as part of the cost stack, wholesale and environmental costs (and the additional GST component) are volatile and fluctuate daily. Sufficient accuracy or buffer in each item of the cost stack may be prudent given the thin margin retailers operate on in Victoria. When wholesale, network and retail risk and other associated costs are not accurately priced or recognised in the VDO, there is insufficient buffer to achieve the return for taking on the associated risk. Inadequate allowance for these costs creates an environment where retailer margins are unsustainably below ESC targets, which adds uncertainty for retailers and limits their ability to invest in developing business systems to increase efficiency (and drive down retailer costs over the medium to long term) and deliver improvements for consumers.

Table 1. AER DMO cost allowances

			(incl. GST)				
DMO region	Retail and other costs	Smart meter roll out	Bad debts	% of total increase	CPI	Total	% difference from DMO6
Ausgrid	$211.97	$47.53	$42.13	13%	$17.13	$318.76	28.4%
Endeavour	$211.97	$75.54	$42.13	12%	$18.71	$348.35	29.5%
Essential	$211.97	$70.28	$42.13	12%	$18.41	$342.79	26.9%
Energex	$219.60	$63.27	$40.05	12%	$18.34	$341.26	40.7%
SA Power Networks	$208.10	$65.63	$43.94	13%	$18.03	$335.69	24.1%
		Average	$42.08	12.5%			

Source: Default market offer prices 2025–26: Draft determination, AER 2025

[1] Victorian Default Offer 2025-26: Draft Decision Paper, Essential Services Commission 2025, p. 57

[redacted]

Rising cost of living pressure has driven an increase in the number of customers facing financial difficulties and in turn the credit risk that retailers must carry. Powershop works closely with customers in hardship and has robust mechanisms in place to assist customers to access hardship programs and efficient measures that are proving to help our customers in financial difficulties. As the number of consumers facing financial difficulties rises, the VDO should accommodate for the increased costs retailers take on to assist consumers to minimise and get on top of their debt and assist them through periods of hardship.

We note that there has been an increase in bad debt since the 2023-2024 VDO period and query whether the rising cost of this has been adequately addressed in the draft determination. Powershop draws the ESC's attention to the detailed calculation of bad debts by the AER which we argue is comparable. Table 1 above details the AER's breakdown of total increases in retail costs. The AER's draft DMO has factored in an average 12.5% increase (an average of $42.08, including GST) attributable to rising bad debt costs in New South Wales, Queensland and South Australia.

In its paper detailing the advice to the Victorian Government on the application of VDO, the ESC noted the ACCC assessment in the Retail Electricity Pricing Inquiry, was that Bad debts and debt collection were one of the two main drivers of retail operating costs.[2] The AER and ESC are aligned in the view that bad debt costs are rising, however, the cost increase recognised in the default offer differ considerably. While the smart meter roll out is not relevant to the Victorian context, the cost of bad debt in Victoria is equivalent to other states in the NEM covered by the DMO. Victoria's effective Payment Difficulties Framework (PDF) is working as intended, providing vulnerable consumers access to payment assistance and access to better rates from engaging with their retailers. Given the growing risk of bad debt costs for retailers operating across the NEM and including Victoria, we query whether the ESC's costings are accurately capturing this rising cost as the AER has recognised in the DMO process.

Solar hedging costs

Powershop welcomes the tremendous growth in rooftop solar in helping customers reduce energy costs and grow the base of low carbon energy generation in Victoria. However, this comes with an ongoing impact on load profile estimation, forecasting and hedging strategies with solar generation and exports driving up hedging costs – adding complexity to managing wholesale market risk. Many retailers are likely to hedge at a portfolio level, and include solar (consumption net of exports), which is a cost of AEMO market acquisitions for retailing across a book, and not an isolated cost that can be carved out for specific customer cohorts.

[2] Proposed approach for the Victorian Default Offer, Essential Services Commission, 2019, p. 52

Recognising this cost in the wholesale energy cost stack can be challenging due to the varying sizes of retailer portfolios and levels of solar customers. We proposed to the AER in the DMO process, and suggest the same here, that the ESC could determine the average cost incurred by retailers to serve solar customers in each distribution region. Identifying this cost on a per-customer basis in specific regions (where it is significant) as a retail cost may be more a more efficient way ensure the VDO reflects these additional costs and risks.

The methodology for determining feed-in tariffs (FiTs) and the wholesale electricity costs in the VDO differ markedly. FiTs are calculated based on forecast wholesale spot prices at times renewables are exported to the grid and VDO reflects the costs retailers incur when hedging products over a long horizon (often quarterly).[3] On this basis, feed-in tariffs are not a proxy for retail hedging. Feed-in tariffs do not reduce risk around export or discount the need for solar export to be recognised in VDO calculations. This is not representative of a typical retailer's costs, nor is it an avoidable cost that can be excluded from their profiles and hedging activities.

As noted by the ESC, retailer residential load profiles may be exposed to five-minute intervals where they are net exporters when the pool price is typically negative. This exposure is not adequately covered by standard hedging products in the market. Negative pool price periods currently account for about 5% of settlement periods, but the frequency of negative intervals is expected to increase as solar penetration continues to rise in Victoria.

Alternative strategies to manage these costs including load shifting and demand response levers, such as EV smart charging, are not at scale to have a material impact on carving out the residential retailer's load profile against the rate of solar penetration growth.

Addressing these developments requires substantial retailer investment in new system capabilities, products, and ongoing customer support, which, like solar hedging, are increasing and may not be fully accounted for in the current cost stack. Given the limited ability for residential retailers to exclude these costs from their profiles, we encourage the ESC to recognize these costs in some form to support development of these capabilities and aid further consumer adoption.

Future VDOs should also consider solar export tariffs imposed by distributors, and how retail costs accommodate this change.

Environmental costs

Powershop supports the ESC's methodology and continued inclusion of environmental costs in the VDO. Although these costs impact the price consumers pay for energy, they are unavoidable costs that accurately reflect Victorian Energy Efficiency Certificates and federal renewable energy target schemes and the prevailing market prices for these schemes and certificates. The ESC rightly acknowledges that including these costs, which retailers must pay to comply with Commonwealth and state or territory laws, is a legitimate component in the VDO cost stack.

[3] Proposed approach for the Victorian Default Offer, Essential Services Commission, 2019, p. 24

Shell Energy welcomes further engagement on this topic. If you have any questions or would like further details relating to this submission, please contact Brett Crossley at [redacted]

Yours sincerely,

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