ESSENTIAL SERVICES COMMISSION

Victorian Default Offer 2022–23

Final decision

24 May 2022

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Contents

The Victorian Default Offer will generally increase from 1 July 2022

- On average, the annual bill for typical residential and small business customers on the Victorian Default Offer will be five per cent higher in 2022-23.
- While an increase in forecast wholesale electricity prices is the main reason for a general increase in the Victorian Default Offer, outcomes across the state vary due to the different path of network tariffs in each of Victoria's five distribution zones.
- For residential customers, Victorian Default Offer bills will increase by around one per cent in the CitiPower zone, with higher wholesale electricity prices largely offset by lower network tariffs.
- There will be increases in other zones, with typical residential bills up by three to five per cent in the Jemena, Powercor and United Energy zones.
- The estimated annual bill for a typical household in the AusNet Services zone will rise by nine per cent. As well as higher wholesale electricity prices, the rise in the AusNet Services zone mainly reflects a relatively large increase in its network tariffs for 2022-23.
- Standing offer prices will remain well below where they were prior to the introduction of the Victorian Default Offer in 2019; with annual bills around $450 lower for a typical residential customer and $2,400 lower for a typical small business customer (averaged across all five distribution zones).

The Victorian Default Offer was introduced by the Victorian Government to regulate standing offer prices for electricity in Victoria. The first Victorian Default Offer covering the period from 1 July 2019 to 31 December 2019 was set by the Victorian Government based on advice prepared by the commission. The commission first determined Victorian Default Offer prices from 1 January 2020.

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 further contract
- moved into a new address and uses electricity without entering into a contract or
- specifically asked for a standing offer.

The Victorian Default Offer specifies the prices that may be charged for standing offers. Around 200,000 households and 50,000 small businesses are on standing offers. This represents around seven per cent of households and 16 per cent of small businesses.

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

Most customers are on market contracts however, not standing offers. And there continues to be a range of market offers available with prices below the Victorian Default Offer.

The Victorian Default Offer plays a key role in the market with retailers required to use it as a common reference price when advertising their market offers and discounts. This enables customers to easily compare market offer prices and choose a plan that best suits their needs.

Since September 2020, the Victorian Default Offer has also applied as a maximum price for most embedded network customers (covering around 140,000 customers).[1] Electricity providers in embedded networks may set prices below the Victorian Default Offer.

We must review prices before the end of each regulatory period

The pricing order issued under the Electricity Industry Act 2000 gives us the role of setting prices for standing offers.[2] Retailers are obliged to make certain types of standing offers available to domestic and small business customers.[3] All standing offers must be made available at prices that comply with the prices or compliant maximum annual bill amounts (as may be relevant) determined by the commission.[4]

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[1] Embedded networks supply electricity for many domestic and small business customers in apartment buildings, caravan parks or office blocks. A domestic customer is a person who purchase electricity principally for personal, household or domestic use. A small business customer is a person who consumes no more than 40 megawatt hours of electricity per year. Prices for electricity supplied within embedded networks are regulated and are required to be set at a level that does not exceed the price payable for the supply or sale of electricity under the Victorian Default Offer. Source: Essential Services Commission, Maximum prices for embedded networks and other exempt sellers: Final decision, July 2020, p. ii.

[2] Order in Council made under section 13 of the Electricity Industry Act 2000 and published in the Victorian Government Gazette No. S 208 on Thursday 30 May 2019. An amendment to schedule 1 was ordered in the Victorian Government Gazette, No. S 216 Tuesday 4 June 2019 (updating controlled load charges). A standing offer is defined in section 3 of the Electricity Industry Act 2000 and means a 'licensee standing offer' or a 'regulated tariff standing offer' as defined in section 3 of this Act.

[3] Clause 7 of the pricing order obliges retailers to make (a) a flat tariff standing offer, as well as a flat tariff standing offer with controlled load, available to each domestic customers at prices determined by the commission; (b) a flat tariff standing offer available to each small business customers at prices determined by the commission; and (c) for standing offers that are not flat tariffs, or are a combination of a flat tariff and a tariff that is not a flat tariff, one or more standing offers available to domestic and small business customers at tariffs that comply with maximum annual bill arrangements determined by the commission.

[4] With effect from 1 September 2021, the commission has determined, under authority of clause 10.3 of the pricing order, that if a retailer charges a domestic or small business customer tariffs under a standing offer that contains a two period time of use tariff, the retailer must charge the tariffs determined by the commission.

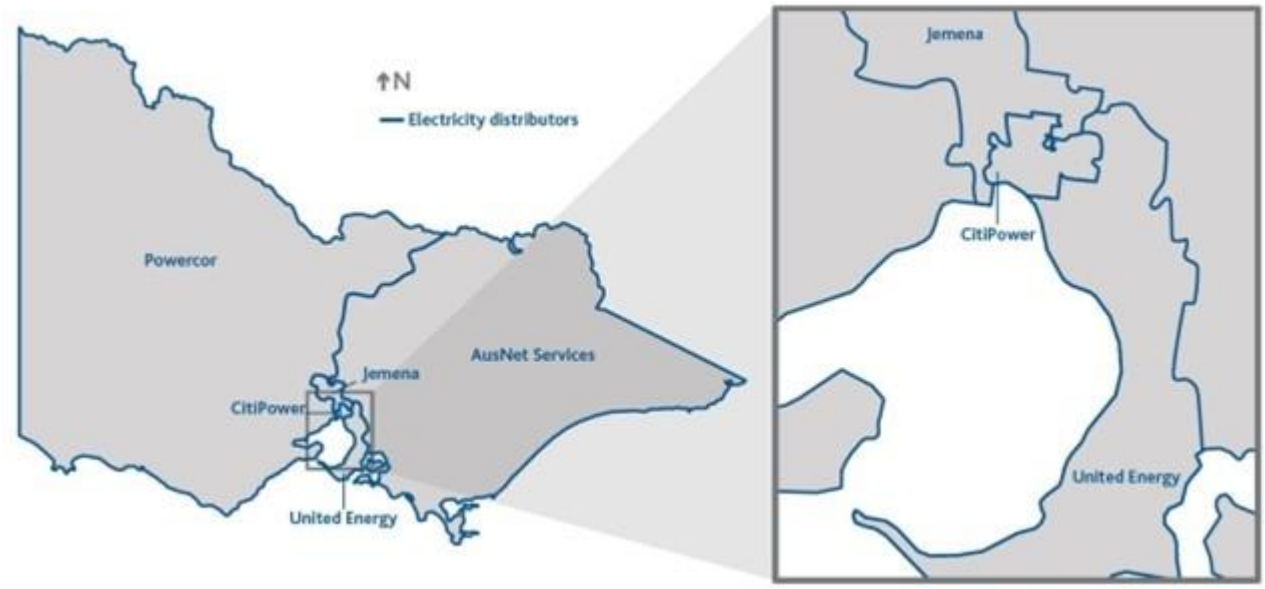
Our previous determination was issued on 25 November 2021, which established Victorian Default Offer prices and compliant maximum annual bill arrangements for the regulatory period 1 January 2022 to 30 June 2022.[5] We refer to these arrangements for standing offers for this period as the 1 January 2022 Victorian Default Offer.

Under the pricing order, we must make a new determination for Victorian Default Offer tariffs to apply for the 12-month regulatory period commencing 1 July 2022. We refer to prices and compliant maximum annual bill arrangements determined for these standing offers for this regulatory period as the 2022-23 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 which is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity market.

There are five electricity distribution zones in Victoria. See figure 1. Each zone has unique characteristics which determine their respective tariffs, which are approved by the Australian Energy Regulator. We determine different Victorian Default Offer prices in each zone, because of the different costs facing electricity retailers in accessing network services in each area.

Figure 1: Map of Victorian electricity distribution zones



[5] A six-month period was adopted to enable us to match the timing of Victorian Default Offer price changes with network tariff changes from 1 July 2022.

Key drivers affecting the 2022-23 Victorian Default Offer

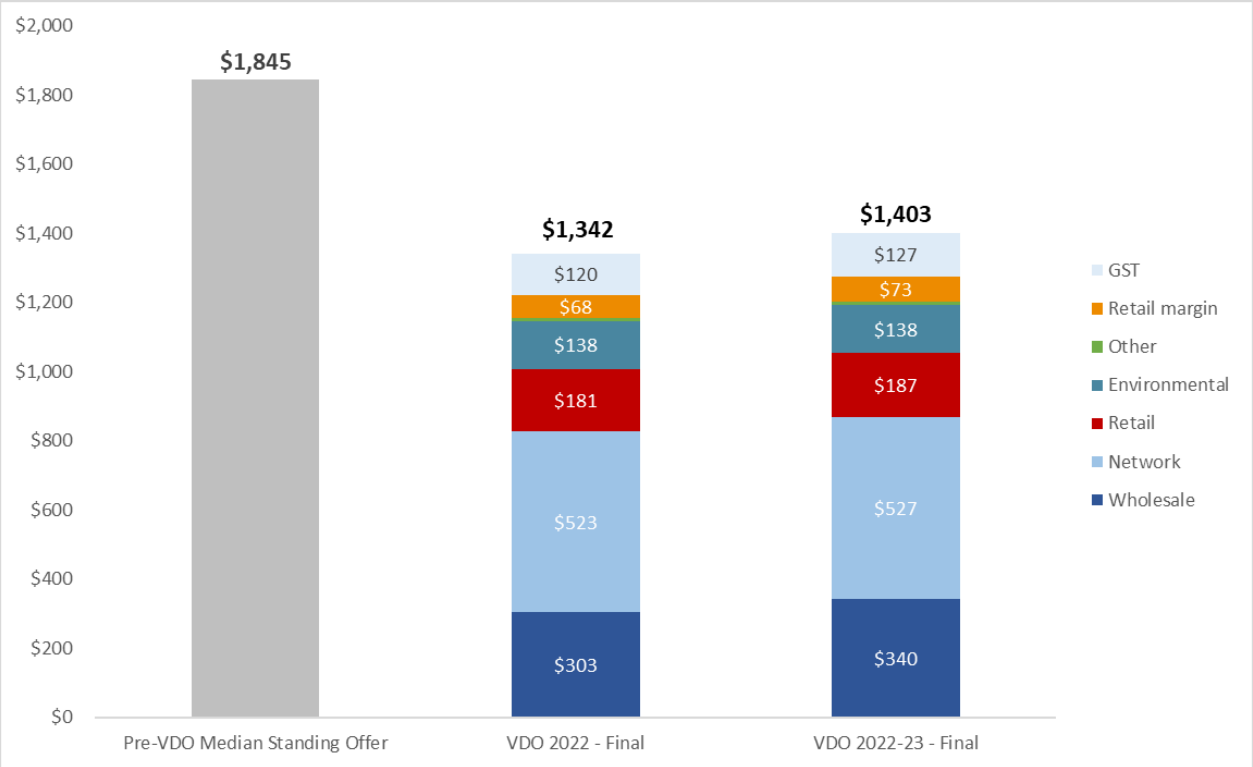
Averaged across all distribution zones, annual bills for residential and small business customers on the Victorian Default Offer will increase by around five per cent. (Based on the most recent outcome for inflation[6], we note this implies the default offer is close to unchanged in real terms.)

The annual bill for a typical residential customer will increase from $1,342 under the 1 January 2022 Victorian Default Offer to $1,403 in 2022-23. See figure 2. The average annual bill for a typical small business will rise from around $5,350 to $5,620. See figure 3.

The main reason for the increase is a forecast rise in wholesale electricity costs, reflecting recent changes in market conditions and rising energy prices.

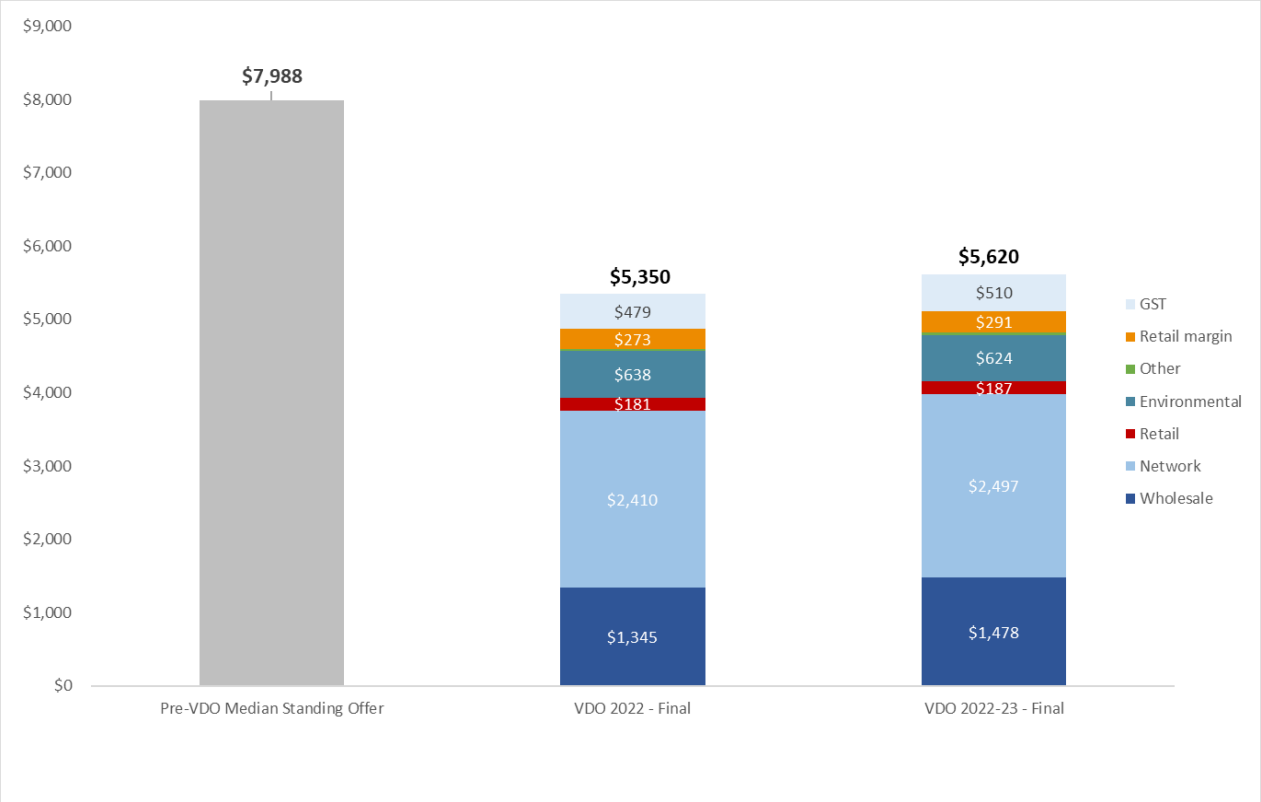
For residential customers, the wholesale electricity cost benchmark has increased by around 12 per cent, accounting for almost two-thirds of the increase in the Victorian Default Offer. Other reasons for the overall increase include adjustments to retail costs (covering retail operating costs and customer acquisition and retention costs) to reflect updates for inflation, and an overall increase in network costs (noting the key differences by distribution zone discussed below).

Figure 2: Change in Victorian Default Offer annual bills for domestic customers



[6] Measured by the change in the All Groups Consumer Price Index over the year to March 2022 and published by the Australian Bureau of Statistics.

Figure 3: Change in Victorian Default Offer annual bills for small business customers



While increasing (on average) in 2022-23, standing offer prices remain well below their levels prior to the introduction of the Victorian Default Offer. In terms of an annual average bill, standing offers in 2022-23 will remain around $450 (figure 2) lower for residential customers and $2,400 (figure 3) lower for small businesses, compared to bills before the introduction of the Victorian Default Offer.

Outcomes vary across distribution zones

Pricing outcomes vary across the state's five distribution zones. See Table 1. Estimated annual bills for a typical household on the Victorian Default Offer in the CitiPower zone will rise by around one per cent, with lower network costs largely offsetting increases in wholesale electricity costs. Bills will increase by between three and five per cent in the Jemena, Powercor and United Energy zones.

The increase is highest in the AusNet Services zone (around nine per cent). As well as higher wholesale costs, the increase in the AusNet Services zone mainly reflects a relatively large increase in network tariffs in its region for 2022-23. Higher network tariffs in the AusNet Services zone were mainly due to 2021-22 tariffs being lowered by handback of previously over-recovered

revenue to customers, inflation, a pass-through of performance incentive rewards, costs related to 2019-20 bushfire and June 2021 storms in the region, and a decrease in forecast consumption.[7]

Table 1: Victorian Default Offer annual bills in 2022-23, $ nominal, inclusive of GST

Distribution zone	Domestic			Small business		
	1 Jan 2022 Victorian Default Offer	2022-23 Victorian Default Offer	Change in 2022-23,	1 Jan 2022 Victorian Default Offer	2022-23 Victorian Default Offer	Change in 2022-23
AusNet Services	$1,494	$1,632	$138	$6,934	$7,656	$722
CitiPower	$1,278	$1,293	$15	$4,713	$4,839	$126
Jemena	$1,315	$1,352	$37	$5,328	$5,413	$85
Powercor	$1,358	$1,412	$54	$4,969	$5,191	$222
United Energy	$1,266	$1,324	$58	$4,806	$5,003	$197
Victoria (average)	**$1,342**	**$1,403**	**$61**	**$5,350**	**$5,620**	**$270**

Note: Annual bills are calculated based on consumption of 4,000 kWh per year for domestic customers and 20,000 kWh per year for small business customers.

We generally kept the same approach to set the Victorian Default Offer

We consider that generally using the same approach as we did in our 1 January 2022 Victorian Default Offer price determination will best meet our legislative objectives (set out at Appendix A). We made this decision after considering all matters raised by stakeholders, and all relevant provisions and matters we must have regard to under the Essential Services Commission Act 2001 (ESC Act), Electricity Industry Act 2000 (EI Act) and the pricing order (provided at Appendix B).

We have changed some parts of our methodology. See table 2. These have a relatively small impact on the 2022-23 Victorian Default Offer. More detail is provided later in the report.

[7] Australian Energy Regulator, Statement of reasons: AusNet Services' Annual Pricing Proposal, May 2022; AusNet Services cover letter, 2022-23 Electricity Pricing Proposal Submission, 6 April 2022.

Table 2: Updates to our approach for the 2022-23 Victorian Default Offer

Cost item	Past approach	Final approach for 2022-23 Victorian Default Offer
Wholesale electricity	We used five years of historical data to estimate electricity demand which is used to calculate the wholesale cost forecasts.	• We have used the three most recent years of data to estimate electricity demand/load. • This is to reflect the changed pattern of electricity demand resulting from investment in rooftop solar. • This has an impact of less than around $3 on the average residential Victorian Default Offer bill.
	Market data on contract prices used to inform forecasts have typically been taken up to four to seven weeks prior to issuing our determination.	• Due to the significance of wholesale costs to the Victorian Default Offer, and recent sharp changes in market prices for electricity, we have updated market estimates for contract prices later for this determination (reading up to 6 May 2022).
Metering	We used the cheapest meter configuration to calculate metering costs.	• We used a customer weighted average approach to calculate metering costs. • The change is to better estimate the efficient costs associated with metering. • This has an impact of around $4 on the average residential Victorian Default Offer bill.

Our consultation and updates since the draft decision

We started our engagement on the 2022-23 Victorian Default Offer in late 2021, seeking feedback from stakeholders on any matters they considered we should take into account.[8] We received seven submissions, which we considered prior to making our draft decision in March 2022.[9]

Following the release of our draft decision, we held a public forum on 31 March 2022 to outline the reasons for our initial views and provide an opportunity for stakeholders to have their say and ask questions. We also received 11 submissions responding to our draft decision. The submissions are listed in Appendix F.

Consultation on the 2023-24 Victorian Default Offer

Following our 2022-23 determination, the next Victorian Default Offer regulatory period will begin on 1 July 2023. We will provide further details on our engagement approach to the 2023-24 Victorian Default Offer at a later time.

The pricing order governing our role is currently under review. An expert chair has been appointed by the Minister for Energy, Environment and Climate Change to lead the review, with a final report to be released by June 2022. The feedback received through the consultation process for the review will inform advice to the Minister for Energy, Environment and Climate Change on whether

[8] Essential Services Commission, 1 January 2022 Victorian Default Offer: Final decision, 25 November 2021

[9] Essential Services Commission, Victorian Default Offer 2022–23: Draft decision, 15 March 2022

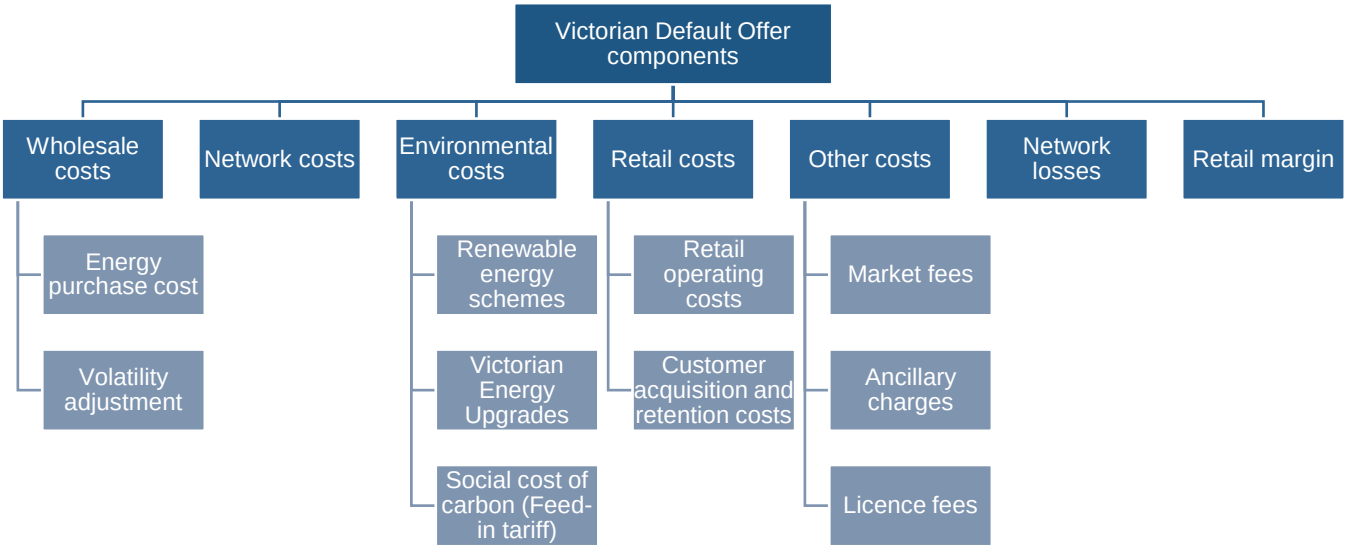
changes to the pricing order are recommended.[10] Any changes, depending on their timing, may impact the nature of our engagement for the 2023-24 Victorian Default Offer.

[10] Review of the Victorian Default Offer Order in Council, accessed 18 May 2022, https://engage.vic.gov.au/review-of-the-victorian-default-offer-order-in-council

Victorian Default Offer cost components

We must base the Victorian Default Offer tariffs on the efficient costs of the sale of electricity by a retailer.[11] We are also required to have regard to a number of cost components in setting tariffs.[12]

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



A summary of our approaches to estimating the amount each item makes up in the total Victorian Default Offer costs is as follows:

- 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 benchmarks from previous regulatory decisions
- other 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.

As well as considering further information provided to us by stakeholders, since our draft decision we have updated parts of the cost stack to reflect more recent information, including those that rely on market data such as wholesale and environmental costs. A reconciliation of changes to cost estimates relative to our draft decision is provided in Appendix G.

[11] Clause 12(3) of the pricing order.

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

Wholesale electricity costs

- Our final decision is to use forecasts of wholesale electricity prices based on futures prices from ASX Energy. This was our approach in past determinations.
- We used the average of forecast wholesale costs for the 12-month period 1 July 2022 to 30 June 2023. This is also consistent with the approach used in past reviews.
- Based on the benchmarks we adopt for the Victorian Default Offer, wholesale electricity purchase costs make up around 24 per cent of an annual residential bill (averaged across the five distribution zones).
- Wholesale electricity costs in our final decision are 12 per cent higher than the allowance in the 1 January 2022 Victorian Default Offer for residential customers and 10 per cent higher for small business customers.

We forecast higher wholesale electricity purchase costs

Retailers incur wholesale electricity purchase costs when they buy electricity from the wholesale market to meet customer demand. The pricing order requires us to have regard to the efficient costs of providing retail electricity services, including wholesale electricity purchase costs.[13]

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 to meet customer demand. Some retailers own generators, but many buy electricity directly from generators on the spot market.[14] Buying electricity from the spot market exposes retailers to the risk that 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, at least some of the prices it pays are set in advance or capped. Retailers can hedge by either contracting directly with a generator, or through a market transaction on ASX Energy or with another financial intermediary.

We used a futures market approach to estimate a benchmark for wholesale electricity costs for 2022–23. The futures market approach is based on an estimate of the costs a retailer would incur to supply electricity to customers using financial hedging products purchased on ASX Energy. We have used this approach in previous Victorian Default Offer determinations.

[13] Clauses 12(3) and 12(4) of the pricing order.

[14] 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 price. Source: Australian Energy Market Operator, spot and contract markets, accessed 29 April 2022, https://www.aemc.gov.au/energy-system/electricity/electricity-market/spot-and-contract-markets.

The futures market approach has several strengths. It provides more transparency than alternatives as it uses publicly available data. It also replicates the approach an efficient retailer would take to minimising wholesale costs and managing financial risks through hedging. And as it is based on market prices, it allows the Victorian Default Offer to reflect recent changes in the price of electricity. Other Australian regulators also use the futures market approach.[15]

Our final decision forecast for wholesale electricity costs is 12 per cent higher than the benchmark adopted for the 1 January 2022 Victorian Default Offer for residential customers and 10 per cent higher for small business customers. The main driver is increased wholesale electricity contract prices.[16]

Estimating wholesale electricity purchase costs

We engaged Frontier Economics to estimate wholesale electricity purchase costs. We considered their approach and accept their recommendations reflect an appropriate benchmark for efficient wholesale electricity purchase costs. A full description of Frontier Economics' methodology including data sources is included in its report.[17] A summary is provided below.

Frontier Economics forecasts demand using Monte Carlo simulations

The first step in Frontier Economics' methodology is to forecast demand and the relationship between price and demand. It analysed 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 Frontier Economics' 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 prices in each quarter is equal to the relevant

[15] Other regulators including the Queensland Competition Authority, the Independent Competition and Regulatory Commission (in the ACT) and the Australian Energy Regulator have used a futures approach to forecast wholesale electricity costs.

[16] Frontier Economics, Wholesale electricity costs for 2022-23: A final report for the Essential Services Commission, May 2022, pp. 27-31.

[17] Frontier Economics, Wholesale electricity costs for 2022-23: A final report for the Essential Services Commission, May 2022.

[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).

quarterly ASX Energy base swap price for 2022-23, subtracting a contract premium.[19] These simulations give a range of possible outcomes for demand and the relationship between price and demand for 2022-23.

Frontier Economics then selects an efficient hedging position using its STRIKE model

With this range of possible demand outcomes, Frontier Economics then estimates the hedging position a prudent retailer would adopt. To estimate the cost of financial hedging, we asked Frontier Economics to use 12-month trade-weighted hedging contract prices from ASX Energy (base swaps, peak swaps, and base $300 caps). An efficient contracting position was then estimated using Frontier Economics' STRIKE model. The model uses the ASX 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.

The Frontier Economics' approach is consistent with the approach we used in the 1 January 2022 Victorian Default Offer, except that Monte-Carlo simulations to estimate demand are based on data from the most recent three calendar years available (2019 to 2021) instead of all available years. This change in approach was proposed in our draft decision.

In recent years we have seen record levels of investment in rooftop solar. This has altered the pattern of demand for and supply of electricity. These changes mean that data from earlier years on demand and the relationship between demand and prices no longer reflect what is currently happening in the energy market. Frontier Economics noted that there is:

> … increasing evidence that patterns of load and patterns of prices are exhibiting a trend, with load and prices both tending to be lower during the day. While the evidence of this trend is still somewhat mixed for load (given that we are considering load for two customer types and 5 DNSPs), the evidence of this trend is clearer at this stage for pricing patterns.[20]

Frontier Economics recommended using the three most recent years of data in the Monte Carlo simulations as it would provide more accurate forecasts of demand than using all years available.[21]

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

[20] Frontier Economics, Wholesale electricity costs for 2022-23: A final report for the Essential Services Commission, May 2022, p.18.

[21] Frontier Economics, Wholesale electricity costs for 2022-23: A final report for the Essential Services Commission, May 2022, p.18-19.

We agree with Frontier Economics' recommendation as it will lead to more accurate wholesale cost forecasts. This impacts the wholesale cost benchmark by less than one per cent.

Why are wholesale costs in the Victorian Default Offer and feed-in tariffs different?

Wholesale electricity cost forecasts for the 2022-23 Victorian Default Offer are higher than the forecasts for the minimum feed-in tariff. This is because wholesale prices during the day, when most solar energy is generated, have moved in a different direction to the wholesale pricing during other times of the day over the last few years.

Additionally, the wholesale cost estimates for this decision were made using market information until 6 May 2022. For the minimum feed-in tariff applying from 1 July 2022 the final decision estimates were made using market information until 14 January 2022.[22] So the wholesale costs in this decision accounts for the recent changes in the wholesale market.

Our wholesale cost forecasts factor in network losses

When electricity is transported through transmission and distribution networks, some of it is lost in the process. 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, and as such they need to be reflected in the benchmark we establish.

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

Our draft decision proposed 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 Services zones.[23] This is the approach adopted for the 1 January 2022 Victorian Default Offer.

We received no new information following our draft decision that cause us to change our approach. Accordingly, our final decision adopts the same as the approach set out in our draft decision.

In calculating the marginal loss factor, we take a simple average of the relevant regional reference node factor for each distribution zone.[24] We remove some transmission nodes that do not have any

[22] Essential Services Commission, Minimum electricity feed-in tariff to apply from 1 July 2022: Final decision, 24 February 2022

[23] Australian Energy Market Operator, Distribution Loss Factors for the 2022-23 Financial Year, April 2022, p. 12.

[24] Australian Energy Market Operator, Marginal Loss Factors: Financial Year 2022-23, April 2022, p. 23-25.

residential or small business load. We combine these to calculate an adjustment factor which is applied to energy purchase costs, environmental costs, and ancillary charges.

We considered stakeholder feedback on wholesale electricity costs

In response to our draft decision, stakeholders raised several matters related to wholesale costs.

Historical data used to calculate wholesale cost forecasts

A number of retailers supported our draft decision to use data from the most recent three years available (2019 to 2021) instead of all available years to estimate demand, including AGL, Alinta Energy, Red Energy and Lumo Energy, Simply Energy, and Origin Energy.

However, Red Energy and Lumo Energy cautioned against frequent changes in methodology and suggested we provide stakeholders with at least 12 months' notice of any changes to ensure they can be reviewed. Similar views were noted by Alinta Energy.

We acknowledge the merits of regulatory consistency, noting our decisions also need to be informed by the latest available information and what we consider best meets the requirements of the pricing order.

Wholesale forecast period

AGL noted that Victorian Default Offer prices from 1 January 2022 are only applicable for six months. It considered that since the prices were derived using wholesale cost forecasts over 12 months, a one-off adjustment is needed to ensure retailers cover reasonable costs over the period to 30 June 2023.

We retain the position set out in our draft decision, that retaining our current approach to forecasting wholesale electricity costs best meets the objectives of the pricing order. Our approach considers the financial viability of the retail electricity sector and is in the long-term interests of Victorian consumers.[25] The consistent use of a 12-month average of estimated wholesale costs will allow retailers to recover their efficient costs over the long term. It should also support price stability for customers.

Frontier Economics' modelling

Origin Energy queried whether a retailer could have reasonably built Frontier's proposed portfolio or contract position over the last 12 months. It further raised that the range of swap levels in the lowest risk portfolio might introduce subjectivity into the portfolio. It recommended that Frontier Economics publish efficient frontier charts with selected portfolio highlighted along with details of

[25] Essential Services Commission, 1 January 2022 Victorian Default Offer: Final decision, November 2021, p. 12; Essential Services Commission 2022, Victorian Default Offer 2022–23: Draft decision, 15 March 2022 p.13;

any sensitivity analysis conducted. It also recommended that the commission include a risk premium in the calculation of the volatility allowance in response to higher spot price volatility.[26]

As outlined by Frontier Economics in its report, the commission's methodology is based on retailers establishing their contract position over a period of 12 months prior to the start of a new Victorian Default Offer regulatory period. The methodology adopted by Frontier Economics uses publicly available data to establish these positions – as a result, retailers do not need perfect foresight of future conditions to build Frontier Economics' ultimate contract position. Retailers can adjust their contract position over time as more information becomes available.

We also agree with Frontier Economics' commentary on aspects of Origin Energy's submission:

- That Frontier Economics does not exercise any subjective judgement in identifying the proposed contract position. Rather, contract positions are calculated using STRIKE. We intend to publish spreadsheets prepared by Frontier Economics (along with their report) that enable analysis on how the wholesale electricity costs change with the contract position.[27]
- The volatility allowance included in the Frontier Economics methodology is already a risk premium.[28]

We also note that Frontier Economics' methodology already includes some relatively conservative assumptions that is intended to provide for competition from smaller and new-entrant retailers.[29] In this way, our methodology has regard to the financial viability of the industry and competition in the market, as required by the framework set out in the pricing order.

Pass through of wholesale costs

Consumer Action Law Centre noted past wholesale price falls have not fully flowed through to consumers. It states that the wholesale electricity cost forecasts should be treated as an upper bound, rather than an efficient cost. In line with submissions made to previous reviews, it recommended we incorporate the range of risk-management strategies available to retailers.[30] It also recommended we delay the change in approach to using data from the most recent three

[26] Origin Energy, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 2

[27] Frontier Economics, Wholesale electricity costs for 2022-23: A final report for the Essential Services Commission, May 2022, p.34-35.

[28] Frontier Economics, Wholesale electricity costs for 2022-23: A final report for the Essential Services Commission, May 2022, p.53.

[29] See for example Frontier Economics, Wholesale electricity costs for 2022-23: A final report for the Essential Services Commission, May 2022, p. 33-34.

[30] Consumer Action Law Centre, submission to the Essential Services Commission Victorian Default Offer to apply from 1 January 2021: Consultation Paper, July 2020, p. 4-5

years available to estimate demand, until consumers receive the benefit of price decreases and reviewed to ensure it aligns with actual costs.[31]

As noted above, we use a market-based approach to forecast wholesale costs. This approach has the advantage of being transparent. We consider that information on over the counter contracts, power purchase agreements and vertical integration is not readily available or as transparent.

In terms of pass through of changes in actual costs facing retailers, we also note our approach is based on establishing benchmark costs based on the latest available information. A typical outcome is that costs will vary from these benchmarks – either higher or lower over a regulatory period. However, generally the Victorian Default Offer will not be adjusted within a regulatory period, noting relevant standing offer contracts must be set at the level specified in our determination. We consider this provides for certainty and is consistent with a simple approach. This does not preclude retailers from passing on cost savings in relation to their market contracts, which are not regulated by the Victorian Default Offer and cover the vast majority of customers.

Impact of recent increases in wholesale prices

Some retailers commented on recent wholesale electricity price increases. ReAmped Energy noted that global geopolitical issues have resulted in higher wholesale prices. It suggested that the commission should increase the allowance for wholesale costs and consider an out of cycle review if the increase in prices continue.[32]

Given the significance of the wholesale electricity cost forecasts in the cost stack and the recent sharp changes in contract prices, we asked Frontier Economics to update wholesale cost estimates to reflect more recent data than readings taken in our past reviews (with market data readings taken to 6 May 2022). We consider this is consistent with our obligation to have regard to the financial viability of the industry.

We also note the within period reopening provisions available in the determination for us to consider large and unforeseen changes in circumstances, including for wholesale costs.

Network costs

- Our final decision continues to use a pass through approach for network costs.
- Our final decision uses the network tariffs approved by the Australian Energy Regulator for 2022–23. These were approved in May 2022 after the release of our draft decision.

[31] Consumer Action Law Centre, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 2

[32] ReAmped Energy, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 2

- We changed our approach to estimating annual metering charges. For our final decision we used a weighted average of meter costs for mass market customers, which is different to the approach adopted for the 1 January 2022 Victorian Default Offer.
- Based on the benchmarks we adopt for the Victorian Default Offer, network costs represent about 38 per cent of the average residential bill (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.[33]

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 final decision is to keep our cost pass through approach

We continued to use the cost pass through approach to establishing a benchmark for network costs, using the 2022-23 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.[34]

Network costs are generally structured in one of two ways:

- a daily supply charge and a flat usage charge (flat network tariffs) or
- a daily supply charge and peak usage and off-peak usage charge (two-period time of use network tariffs).[35]

[33] Clauses 12(4)(b) of the pricing order.

[34] 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.

[35] 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.

We also include metering charges for each distribution zone, and a controlled load option for domestic customers where applicable.

As well as incorporating approved network tariffs, the network cost changes are also impacted by a "true up" included in the 1 January 2022 Victorian Default Offer, which has been removed for the 2022-23 Victorian Default Offer. This generally has a downward impact on network costs.

Overall, network costs for the residential Victorian Default Offer bill will increase by less than one per cent for residential customers and by around four per cent for small business customers (averaged across all five distribution zones).

We changed our approach to metering costs

In previous determinations we used the cheapest meter configuration to estimate metering costs. Submissions from stakeholders prior to our draft decision and data obtained from the Australian Energy Regulator suggested that customers are often not on the cheapest possible metering option.[36] Our draft decision estimated metering costs by calculating a customer weighted average of the different metering costs in each distribution zone rather than the cheapest configuration.

This proposed change was supported by Origin Energy, AGL, Momentum Energy, Simply Energy and EnergyAustralia in their submissions to our draft decision.[37]

Our final decision is to use the customer weighted average metering costs in each distribution zone, based on the Australian Energy Regulator approved 2022-23 network tariffs. We consider using the average cost of all residential and small business meters, weighted by customer numbers, will more accurately reflect efficient costs.

We considered other proposals on metering costs

In response to our draft decision, EnergyAustralia considered our assumption that customers have only one meter is leading to an under recovery of these costs. It noted some customers are paying for two meters. On this, we consider the cost impacts are relatively small on retailers and can be accommodated in the overall cost benchmarks established for the Victorian Default Offer. At this stage, we consider we have insufficient evidence or information to change our approach.

EnergyAustralia also noted that the weighted average approach we use does not consider that small businesses are more likely to be on more expensive meter types than residential customers.

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[36] EnergyAustralia, submission to the Victorian Default Offer 2022-23 (public version), 3 February 2022, p. 5; 2022-23 ACS Tariff Approval Models for each distributor, submitted with Annual Pricing Proposals for 2022-23.

[37] Origin Energy, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 2; AGL, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 2; Momentum Energy, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 3; Simply Energy, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 2; EnergyAustralia, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 3

As a result, under a common weighted average EnergyAustralia notes residential customers may be cross-subsidising the higher meter costs of small business customers. At this stage however, we do not have sufficient information to change our approach.

Approved network tariffs for 2022-23

At the time of making our draft decision the approved network tariffs for 2022-23 were not available. These were approved by the Australian Energy Regulator in May 2022. In our final decision we have incorporated the approved network tariffs for 2022-23.

Across most distribution zones except for AusNet Services, network costs are estimated to slightly increase, remain flat or decrease in 2022-23. The main reasons for the increase in its network tariffs include:[38]

- 2021-22 prices being artificially low as they incorporated handback of over-recovered revenue. The increase in 2022-23 reflects a return to the revenue path set in the 2021-26 AusNet Services distribution network revenue determination.
- Adjustments to reflect recent inflation outcomes.
- Strong reliability performance in 2020 and the first half of 2021, resulting in a performance scheme reward.
- The recovery of costs associated with the June 2021 storms and the 2019-20 bushfire natural disaster impacting its region.
- A forecast decrease in consumption, leading to an increase in prices to allow the distribution business to recover the revenue allowed.

Environmental costs

- Our final decision is to maintain our current approach for estimating the Small-scale Renewable Energy Scheme costs, Large-scale Renewable Energy Target, Victorian Energy Upgrade costs and the minimum feed-in tariff.
- Based on the benchmarks we adopt for the Victorian Default Offer, environmental costs represent about 10 per cent of a residential electricity bill (averaged across the five distribution zones).
- Our final decision means the dollar value of environmental costs in the cost stack will relatively remain unchanged from the amount in the 1 January 2022 determination.

[38] Australian Energy Regulator, Statement of reasons: AusNet Services' Annual Pricing Proposal, May 2022; AusNet Services cover letter, 2022-23 Electricity Pricing Proposal Submission, 6 April 2022.

Under the pricing order, we are required to have regard to environmental costs.[39] There are four main environmental costs faced by Victorian electricity retailers:

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

Our final decision amount for environmental costs remains unchanged from the allowance included in the 1 January 2022 Victorian Default Offer for residential customers. For small business customers the environmental costs components fell by about one per cent from the 1 January 2022 determination, reflecting decrease in "true ups" for costs under the Small-scale Renewable Energy Scheme and Large-scale Renewable Energy Target.

Since our draft decision, we have updated our estimates for more recent information.

Our final decision keeps our approach to environmental costs

Our final decision on how to calculate these components of the Victorian Default Offer is as follows:

- Small-scale Renewable Energy Scheme – the mid-point between the 2022 binding and the 2023 non-binding small-scale technology percentage is multiplied by the clearing house price ($40 excluding GST). A true-up is also included to account for the difference between the forecast small-scale technology percentage used in the 1 January 2022 Victorian Default Offer decision and the 2022 binding percentage.
- Large-scale Renewable Energy Target – the 2022 renewable power percentage is multiplied by the financial year 2022-23 forward market price for large-scale generation certificates. A true up is also included to account for the differences between the 2022 default percentage used in the 1 January 2022 Victorian Default Offer decision and the actual renewable power percentage for 2022.
- Victorian Energy Upgrades – The 12-month trade-weighted average spot price of Victorian energy efficiency certificates is multiplied by the 2022 greenhouse gas reduction rate.
- The above costs are multiplied by network loss factors.
- Minimum feed-in tariff (social costs of carbon) – total renewable exports in the most recent 12-month period is multiplied by the social cost of carbon (2.5 cents per kWh for 2022-23).[40] The

[39] Clause 12.4(c) of the pricing order

[40] From 1 March 2021 to 28 February 2022

resulting figure is divided by the average number of domestic and small-business customers in the same period.

We kept our approach to the Small-scale Renewable Energy Scheme

The Small-scale Renewable Energy Scheme obliges retailers to purchase small-scale technology certificates. The Clean Energy Regulator sets a binding small-scale technology percentage every year which sets the amount of small-scale technology certificates retailers must buy.

Our final decision uses the same approach adopted in previous determinations to calculate the cost of the Small-scale Renewable Energy Scheme. We used the mid-point of the 2022 binding and 2023 non-binding small-scale technology percentage, multiplied by the clearing house price ($40 excluding GST).

We also included a true-up to account for the difference between the forecast percentage used in the 1 January 2022 Victorian Default Offer decision, and the actual 2022 small-scale technology percentage determined by the Clean Energy Regulator. As the benchmarks set by the Clean Energy Regulatory for 2022 (binding) and 2023 (non-binding) are lower than those used in the 1 January 2022 Victorian Default Offer, this has led to a decrease in costs.

No submissions were received that cause us to change our approach to setting a benchmark for Small-scale Renewable Energy Scheme costs.

We kept our approach to the Large-scale Renewable Energy Target

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 large-scale 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.

To estimate the per megawatt benchmark cost for the Large-Scale Renewable Energy Target, we start with the 2022 renewable power percentage calculated by the Clean Energy Regulator. We then multiply the renewable power percentage by the average future market price for 2022-23 large-scale generation certificates. For this decision, we included a true-up to account for the difference between the renewable power percentage used in the 1 January 2022 Victorian Default Offer decision and the actual 2022 percentage. Under current targets, from 2022 onwards the renewable power percentage will remain at 18.64 per cent for the duration of the program.

To meet their obligations, retailers buy large-scale generation certificates from the futures market or enter into power purchasing agreements. As such, 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.

No submissions were received in response to our draft decision that caused us to change our approach to Small-scale Renewable Energy Scheme costs.

We kept our approach to Victorian Energy Upgrades program 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.

The Consumer Action Law Centre supported our draft decision to keep our methodology unchanged.[41] Alinta Energy supported the use of the latest available data when calculating a 12-month trade weighted average of Victorian energy efficiency certificate prices.[42]

We kept our approach to estimating these costs for the Victorian Default Offer, as it ensures retailers can recover their efficient costs over time.

For our final decision, the benchmark cost for the Victorian Energy Upgrades program is estimated by multiplying the 12-month trade-weighted average spot price of Victorian Energy Efficiency Certificates by the 2022 greenhouse gas reduction rate (with spot certificate prices calculated up to 11 April 2022).

We calculated a certificate price of $73.62 excluding GST, which using the 2022 greenhouse gas reduction rate of 0.16113 gives a Victorian Energy Upgrades cost of $11.86 per megawatt hour. This compares to the $9.82 benchmark for the 1 January 2022 Victorian Default Offer.

We kept our approach to the cost of the minimum feed-in tariff

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

[41] Consumer Action Law Centre, submission to the Victorian Default Offer 2022-23, 8 April 2022, pp. 2-3.

[42] Alinta Energy, submission to the Victorian Default Offer 2022-23, 12 April 2022, pp. 2.

Victorian Government set the social cost of carbon at 2.5 cents per kWh for 2022-23.[43] 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 final decision maintains our current approach to calculating the cost associated with the minimum feed-in tariff. To estimate the cost to retailers, we take the total renewable exports for the most recent 12-month period and multiply this by the social cost of carbon. The resulting figure is then divided by the total average number of domestic and small-business customers over the same period.

No submissions were received in response to our draft decision that caused us to change our approach to setting a benchmark for the cost of the minimum feed-in tariff. We believe this approach to estimating the cost of the minimum feed-in tariff is transparent and is easily replicable. It also allows retailers to recover the efficient costs of paying for solar exports.

Retail operating costs

- Our final decision is to continue to use a benchmarking approach to set retail operating costs. This is consistent with the approach used in our final decision on the 1 January 2022 Victorian Default Offer.
- Based on the benchmarks we adopt for the Victorian Default Offer, retail operating costs represent about 10 per cent of costs in the average residential bill (averaged across the five distribution zones).
- The retail operating costs in our final decision are slightly higher than the amount included in our 1 January 2022 determination, reflecting inflation.

Retail operating costs reflect a range of costs incurred by an electricity retailer in conducting its business. This includes billing and revenue collection systems, information technology systems, call centre costs, corporate overheads, energy trading costs, provision for bad and doubtful debts and regulatory compliance costs.[44]

[43] 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.

[44] Clause 12(4)(d) of the pricing order requires we have regard to retail operating costs, including modest customer acquisition and retention costs, as an element in developing the efficient costs of the sale of electricity by a retailer. We address customer acquisition and retention costs in the next section.

Our final decision is to keep our approach to retail operating costs

The 2022-23 benchmark for retail operating costs per customer is based on an amount of $121.07 excluding GST set by the Independent Competition and Regulatory Commission in its 2017 final decision for retail electricity prices in the Australian Capital Territory. Consistent with the approach taken in previous reviews, we adjusted this benchmark for the change in the consumer price index since 2017 which leads to an annual benchmark of $135.51 excluding GST.

In addition to this benchmark, we set an annual amount for additional regulatory costs and Victoria specific operating costs of $10. This amount was included in the first Victorian Default Offer. It reflects the costs related to operating in Victoria that are not covered by the Independent Competition and Regulatory Commission benchmark, including those associated with the Payment Difficulty Framework.[45] Our final decision also continues to include an amount ($0.84) for ongoing operating expenditure associated with five-minute settlement.

Our final decision annual benchmark of $146.35 per customer excluding GST is higher than the current (1 January 2022 Victorian Default Offer) benchmark of $141.75, reflecting an update for inflation (noting the application of inflation is consistent with our past approach).[46]

The benchmark approach is transparent and based on efficient costs

Our approach to calculating a benchmark for retail operating costs represents a transparent and simple approach. It is replicable and based on public information. Our approach is consistent with the methodology we used in the 1 January 2022 Victorian Default Offer.

The level of our benchmark remains appropriate. We have also cross checked it with data provided by Victorian retailers on their costs. We consider our benchmark provides retailers with a reasonable opportunity to recover efficient costs.

Stakeholder feedback on the retail operating cost benchmark

Generally, submissions from retailers sought an increase in the retail operating cost benchmark proposed in our draft decision, while consumer representative groups generally proposed a reduction in the benchmark and/or the application of a productivity factor.

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[45] Based on the analysis of Victorian specific costs in the Australian Competition Consumer Commission's Retail Electricity Pricing Inquiry final report completed in our final advice to government. For more detail see Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, 3 May, p. 64.

[46] To adjust the components of our retail operating cost benchmark for changes in inflation, we multiply the component by the percentage change in the consumer price index from the time the component was first published to the most recent consumer price index announcement made by the Australian Bureau of Statistics. We then add this figure to the original level of the benchmark component.

The reasons retailers cited for an increase in the benchmark included additional costs associated with operating in Victoria relative to other jurisdictions[47], costs associated with implementation of the consumer data right,[48] and rising capital (or depreciation and amortisation) costs.[49]

We considered whether adjustments were required to reflect these claims.

We note our benchmark already includes an additional allowance for operating in Victoria. Further, while some retailers provided additional (and confidential) information on costs related to the consumer data right in response to our draft decision, after review we retain the view set out in our draft decision that the ongoing operating costs associated with the reforms appear relatively small and should be accommodated within the benchmark adopted in our final decision.

In terms of capital costs, consistent with our draft decision we consider any capital costs associated with the consumer data right (and capital expenditure related to other projects) are accounted for in the retail margin. At this stage, we have insufficient evidence to change our approach to capital expenditure.

More broadly, and noting the additional cost claims by retailers, we note the operating cost benchmark in our final decision sits within the range of (median) retail operating costs reported by retailers in recent years (noting the data was obtained under our formal information gathering powers provided under the ESC Act).

The average of the median value for retail operating costs reported by retailers in each year (in response to our formal information requests issued under the ESC Act) from 2017-18 to 2020-21 is $140, below the benchmark adopted in our final decision. The median value for 2020-21 was lower than this four-year average.

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[47] AGL, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p. 3.

[48] EnergyAustralia, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p. 3, Momentum Energy, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 11 April 2022, p. 2, Origin Energy, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p.3, Red Energy and Lumo Energy, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p. 4, AGL, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p. 2, Alinta Energy, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p.3.

[49] AGL, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p. 2, EnergyAustralia, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p.3, Momentum Energy, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 11 April 2022, p.2, Origin Energy, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p.3.

After considering the additional cost claims by retailers, and reviewing the costs reported by them in response to our information requests, we consider the benchmark used to determine the 2022-23 Victorian Default Offer provides retailers with a reasonable opportunity to recover efficient costs.

Among consumer representative groups, both the Victorian Council of Social Service and Energy Consumers Australia considered we should adopt or commit to implementing a productivity factor. We note our preferred approach is to cross check our benchmark to the cost data reported to us by retailers, as this enables us to consider movements in actual retailer costs, either up or down.

Consumer Action Law Centre stated that the benchmark should be set at the average level of reported retail operating costs in the Australian Competition and Consumer Commission's 2017-18 Retail Electricity Pricing Inquiry.[50] The reasons we have not adopted this data are set out in our 2019 advice to the Victorian Government on the Victorian Default Offer methodology.[51]

The Consumer Action Law Centre also recommended we review retailer operating costs to identify any efficiencies arising from recent reforms.

As noted above, we consider the benchmark we have adopted is reasonable, taking into account the cost data reported by retailers in recent years. At this stage, we have not observed changes in retailers reported cost data that can be attributed to recent regulatory reforms.

Moreover, at this stage we do not have sufficient evidence to confirm that the observed reduction in (median) operating costs reported to us by retailers in 2020-21, represents a sustained reduction in costs. Nor have stakeholders had an opportunity to comment on any reduction to the benchmark based on the cost data and its potential impacts.

An adjustment for bad debts associated with the pandemic is not required

In our determination for the 1 January 2022 Victorian Default Offer, we removed the temporary additional $6 included in the retail operating cost benchmark to reflect bad debts associated with the coronavirus pandemic. Our draft decision for the 2022-23 Victorian Default Offer also proposed not to include any additional allowance for bad debts, outside the baseline cost of bad debts already included in our retail operating cost benchmark.

Our final decision is to maintain our draft decision and not include an adjustment for bad debts. We received no new information that has caused us to change the views set out in our draft decision. And as noted above, our analysis of cost data suggests the benchmark we have set provides a reasonable opportunity for a retailer to recover efficient retail operating costs.

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[50] Consumer Action Law Centre, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 8 April 2022, p.3.

[51] Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, p. 63-64

Customer acquisition and retention costs

- Our final decision is to keep our approach to estimating customer acquisition and retention costs.
- Based on the benchmarks we adopt for the Victorian Default Offer, customer acquisition and retention costs account for around 3 per cent of costs for the average residential bill (averaged across the five distribution zones).
- Our final decision means the benchmark we set for customer acquisition costs will increase in line with inflation.

The pricing order requires us to take into account modest costs of customer acquisition and retention in making our Victorian Default Offer price determination.[52] These costs include the cost of acquisition channels (such as third-party comparison websites and service providers), the cost of retention teams, and marketing costs targeted at driving customer acquisition or retention.

We kept our approach to acquisition costs

For our final decision, we have set a modest benchmark for customer acquisition and retention costs of $41.01 excluding GST.

In all past determinations for the Victorian Default Offer, we have used a benchmarking approach to derive modest customer acquisition and retention costs.

The benchmark we initially established was based on cost levels from an Australian Competition and Consumer Commission's retail and electricity pricing inquiry final report.[53] We selected the 2013-14 benchmark on the basis that it was the most robust data available that also limited the increased spending on customer acquisition costs that had been observed across most jurisdictions. This has been updated for inflation at each reset for the Victorian Default Offer.

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

[52] Clauses 12(3) and 12(4) of the pricing order.

[53] Australian Competition and Consumer Commission, Retail Electricity Pricing Inquiry: Final report, July 2018.

We considered stakeholder submissions on customer acquisition and retention costs

In responding to our draft decision, Origin Energy and AGL raised the definition of "modest".[54] Origin Energy noted that without a clearer definition it is difficult for retailers to engage constructively in debate on an appropriate benchmark. AGL considered a modest benchmark should represent the average or midpoint of a range of costs, as opposed to the high or low.

We consider our regulatory precedent sets a reasonable guide for a benchmark that reflects "modest" costs of customer acquisition and retention, for the purpose of establishing the Victorian Default Offer. That is, our benchmark is modest in that it is based on limiting the impact (on the Victorian Default Offer) of increased customer acquisition and retention expenditure since 2013-14. The value of the initial benchmark is updated for inflation, so it remains constant in real terms.

In terms of submissions on the level of our benchmark, there were mixed views.

Alinta Energy stated that the commission should consider additional costs associated with a reliance on more costly acquisition and retention channels as a result of the Energy Fairness Plan.[55] We note that in their submission to our consultation paper, Red Energy and Lumo Energy considered that it would be too early to make substantial adjustments to the acquisition costs benchmark following the commencement of the Energy Fairness Plan.[56]

The Consumer Action Law Centre argued that the benchmark for customer acquisition and retention costs should be lowered by the costs of sales tactics no longer permitted under the Energy Fairness Plan, and we should recalculate the benchmark using a bottom-up approach.[57]

We consider there is not sufficient evidence on the impacts of changes in marketing approaches by retailers to change our approach to customer acquisition and retention costs. Further, we note that the benchmark we have set generally sits at the lower end of the costs reported to us by retailers in response to our formal information gathering requests.

Other costs

- Our final decision is to set a benchmark for other regulatory costs that are based on the latest available market information.

[54] Origin Energy, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 3; AGL, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 3

[55] Alinta Energy, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 3

[56] Red Energy and Lumo Energy, submission to the Victorian Default Offer 2022-23, 3 February 2022, p.2.

[57] Consumer Action Law Centre, submission to the Essential Services Commission Victorian Default Offer 2022-23, April 2022, p. 3-4

- Based on the benchmarks we adopt for the Victorian Default Offer, these other costs make up around one per cent of total costs for a representative customer (averaged across the five distribution zones).
- Our final decision marginally increases the amount included for these costs compared with the current Victorian Default Offer.

Other regulatory costs include a range of discrete and specific costs that retailers incur outside of costs to serve. They 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 costs for the sale of electricity by a retailer.[58]

Australian Energy Market Operator fees

These fees are charged to retailers by the Australian Energy Market Operator (market operator) to recover the costs of market operation.

We based our estimate of the market operator's fees in our final decision on its 2022-23 draft budget fees and charges.[59] We note that we have only included the portion of market operator fees that are levied on retailers. We also note that our estimate of the market operator's fees is based on the latest information available from the market operator at the time of the final decision's release.

We also note the recent National Electricity Rule change request by Energy Networks Australia, allowing Transmission Network Service Providers to recover the cost of the market operator's participant fees. The portion of participant fees to which the rule change relates will not be charged to Transmission Network Service Providers until 1 July 2023, so we have not factored in any cost changes to the 2022-23 Victorian Default Offer final decision. However, we will continue to monitor how the rule change affects retailer's costs in the future.[60]

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

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

[59] Australian Energy Market Operator, Presentation to Finance Consultation Committee, Draft FY23 Budget & Fees, March 2022

[60] Australian Energy Market Operator, Energy Networks Australia Rule change request: Recovering the cost of Australian Energy Market Operator's participant fees, June 2021.

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 completed analysis of market operator data to estimate Victorian ancillary charges in the regulatory period beginning 1 July 2022. We used an average of the past 52 weeks (ending 17 April 2022) of ancillary service payments in Victoria. This results in an average ancillary service payment of $0.35/MWh.

Reliability and Emergency Reserve Trader costs

The Reliability and Emergency Reserve Trader is a function conferred on the market operator to maintain system reliability and system security using reserve contracts. The market operator publishes annual and quarterly reports when their reliability and emergency reserve trader functions have been activated. The latest published report was the Australian Energy Market Operator Reliability and Emergency Reserve Trader End of Financial Year Report 2020–21, which showed no activations of the reserve function in Victoria. As such, our final decision does not include an amount for reserve trader costs.[61]

Essential Services Commission licence fees

Electricity retailers are charged an annual licence fee 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 divided by the total number of customers in estimating the cost of a licence fee per customer for the Victorian Default Offer. The latest approved licence fees are for 2020–21. Adjusting this data for inflation results in a benchmark of $2.23 per customer.

Retail operating margin

- Our final decision is to continue to use the benchmarking approach to the retail operating margin we used in our last Victorian Default Offer decision.
- Retail operating margin represents 5.7 per cent of costs for the representative user.
- Our final decision means that the dollar value of the retail operating margin in the cost stack will slightly increase, on average across the five distribution zones.

[61] Australian Energy Market Operator, Reliability and Emergency Reserve Trader End of Financial Year 2020-21 Report, August 2021.

The pricing order requires us to have regard to the retail operating margin when making a Victorian Default Offer price determination.[62]

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 systematic (non-diversifiable) risk associated with investment.[63] The retail operating margin is expressed as a percentage of the cost stack.[64] 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[65], and that we are not required to base our benchmark on actual retailer operating margins.[66]

We have kept the retail operating margin at 5.7 per cent

For the 2022-23 Victorian Default Offer, we have maintained our benchmark approach and adopted a retail operating margin of 5.7 per cent.

We considered stakeholder's submissions on the retail operating margin

There were mixed views on whether we should increase or decrease the retail operating margin.

EnergyAustralia submitted the retail operating margin does not sufficiently provide for retailers' depreciation and amortisation costs, and that depreciation and amortisation should be benchmarked based on actual and current data provided by retailers.[67] It also stated it is unclear if the commission has previously performed a cross check of the retail operating margin against actual retailer data and that the commission must ensure the margin sufficiently covers retailers' actual observed depreciation and amortisation. EnergyAustralia also provided confidential data on its depreciation and amortisation costs.

EnergyAustralia also stated that retailers' capital expenditure (and the associated depreciation and amortisation) related to technology upgrades and new regulatory requirements must be reflected in

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

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

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

[65] Clause 12(7) of the pricing order notes that in determining retail operating margin we must have regard to the principle that the margin must not compensate retailers for risks that are compensated elsewhere in the costs.

[66] Clause 12(9) of the pricing order.

[67] EnergyAustralia, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, pp. 1-3.

the Victorian Default Offer. EnergyAustralia considers capital expenditure is as relevant for purposes of setting the Victorian Default Offer, as operating expenditure.[68]

AGL submitted that the retail operating margin does not account for the increasing depreciation and amortisation costs of energy retailers since the margin was set, which is causing a reduction in the effective margin over time.[69] AGL noted its own depreciation and amortisation costs had increased by 30 per cent from 2018-19 to 2020-21, and to maintain the effective margin, the benchmark must be increased.

In response to EnergyAustralia and AGL, we note that our approach to the retail operating margin already accounts for depreciation and amortisation. We note that in setting an operating margin for the purpose of setting the Victorian Default Offer tariffs, we are not required to consider retailers' actual retail operating margins.[70] We also consider that any individual firm's cost data may not be reflective of the sector for any given cost, particularly depreciation and amortisation given the difference in scale of the retailers in the sector and their relative capital spends.

Further, while we accept that retailers may be incurring capital expenditure to meet regulatory reform obligations and to upgrade technology and IT systems, we consider the current margin remains sufficient for retailers to recoup these costs, noting that our current margin of 5.7 per cent sits at the higher end of retail operating margins set by regulators in similar jurisdictions.

Alinta Energy noted the Australian Energy Regulator set a 10 per cent 'retail allowance' in its draft decision on the Default Market Offer to apply from 1 July 2022, higher than the 5.7 per cent retail operating margin included in the Victorian Default Offer.[71]

We consider the Default Market Offer's retail allowance is not intended to act solely as a retail operating margin and considers a range of factors a standalone retail operating margin would not. We also note the different objectives of the Default Market Offer and Victorian Default Offer.[72]

ReAmped Energy submitted that the Victorian Default Offer must allow for small retailers to recoup a margin to protect competition in the marketplace.[73]

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[68] EnergyAustralia, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, pp. 1-3.

[69] AGL, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p.3.

[70] Clause 12(7) of the pricing order.

[71] Alinta Energy, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p.3.

[72] Clause 12(3) of the pricing order requires that we make our decision based on the efficient costs of the sale of electricity by a retailer.

[73] ReAmped Energy, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p.1.

We consider our approach provides for competition, including for smaller retailers. This is evidenced by a range of market offers that continue to be available with lower prices than the Victorian Default Offer (across retailers of different sizes) and by ongoing entry to the market.[74] We also note the Australian Competition and Consumer Commission found no evidence that the introduction of the Victorian Default Offer had an adverse effect on market offer prices.[75]

Contrasting submissions from retailers, Consumer Action Law Centre submitted the retail operating margin could be reduced given the level of competition, the number of new entrants and productivity improvements in the sector since the Victorian Default Offer was first introduced.[76] Consumer Action Law Centre considered that the commission should undertake bottom-up cost analysis to determine what is an efficient retail margin in the sector.

Energy Consumers Australia raised that given the level of the retail margin set by regulators in other jurisdictions, and previous decisions by other regulators to lower the retail operating margin in response to cost increases, there may be scope for a reduction in the level of the Victorian Default Offer margin.[77] It also shared concerns with the Consumer Action Law Centre, that relying on other regulators benchmarks may lead to a circular approach, which may include inefficiencies.

The retail operating margin covers among other things retailers' cost of capital and includes remuneration for systematic risk through the market risk premium.

Systematic risks include the risk of long-term economy wide downturns such as would be caused by the business cycle, financial crisis, war or a pandemic. At this stage, we consider there is insufficient evidence to support a change in the systematic risk in electricity retail sector.

We also acknowledge that regulators in other Australian jurisdictions have set retail operating margins that sit below the level of our retail operating margin. However, in setting a retail operating margin these regulators have considered the risk profiles retailers face in their jurisdiction. We also consider these regulators have different frameworks and obligations to those we must consider in setting a benchmark for the retail margin for the Victorian Default Offer.

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[74] Since the introduction of the Victorian Default Offer in July 2019, we have received 20 license applications from entities to sell electricity in Victoria, with nine entities being granted licenses to operate a retail electricity business in Victoria servicing residential or small business customers.

[75] Australian Competition and Consumer Commission, Inquiry into the National Electricity Market – November 2021 report, p. 32

[76] Consumer Action Law Centre, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p. 4.

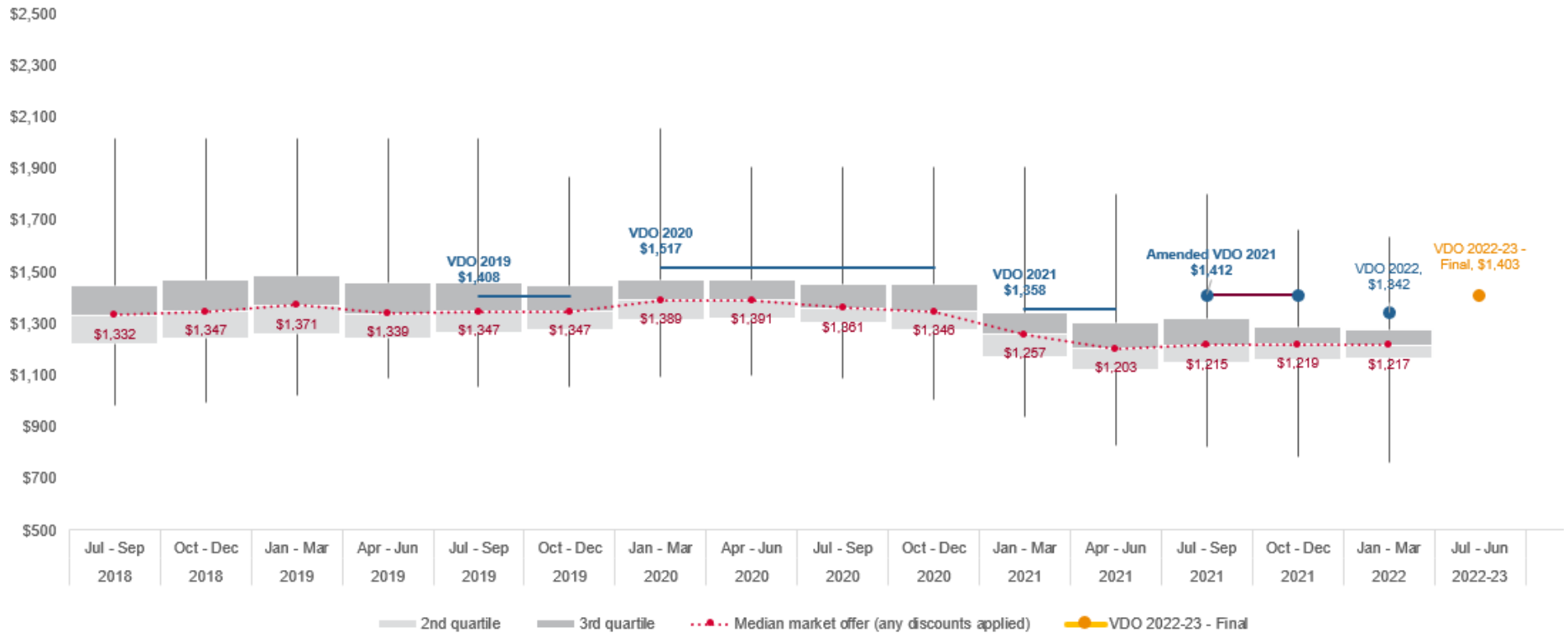
[77] Energy Consumers Australia, submission to the Essential Services Commission Victorian Default Offer to apply from 1 July 2022: Draft decision, 12 April 2022, p. 3.

In light of competing submissions from stakeholders and the above factors, on balance we consider our approach to setting the retail margin continues to meet our requirements in setting the Victorian Default Offer with regard to retailers' efficient costs.

The Victorian Default Offer will allow retailers to recover efficient costs

As well as reviewing the cost data reported to us by retailers, we cross-checked where the Victorian Default Offer prices fall within the range of available market offers. As shown in figure 5, the average 2022–23 Victorian Default Offer bill remains above most market offers. This suggests it allows retailers a reasonable opportunity recover at least their efficient costs.

Figure 5: Annual residential Victorian Default Offer bill compared to market offer bills (4,000 kWh/year)



Note: The Victorian Default Offer prices included here are the average residential bills across all five Victorian distribution zones. We also note there are different ways to visualise the information presented depending on the purpose of the report. For example, all offers for each retailer within a distribution zone at a given time could be displayed to show differences in retailers' price offerings at a given time.

Calculating Victorian Default Offer tariffs and compliant maximum annual bill amounts

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:

1. **flat tariffs -** for standing offers with flat tariffs
2. **two-period time of use tariffs –** for standing offers with two-period time of use tariffs
3. **the compliant maximum annual bill amount** for standing offers with non-flat tariffs, other than two-period time of use tariffs.

The compliant maximum annual bill amount 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 final decision on flat tariffs

Our final decision is to use the same approach to setting standing offer rates for flat tariffs as we did in our 1 January 2022 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.

Stakeholders generally supported our approach to flat tariffs as described in our 2021 Victorian Default Offer determination.[78] They have not raised any issues during our 1 January 2022 Victorian

[78] Essential Services Commission, Victorian Default Offer 2021: Final decision, November 2020, pp. 45.

Default Offer review and our draft decision on the 2022–23 Victorian Default Offer review, that caused us to change our approach.

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 final decision on two-period time of use tariffs

Our final decision is to use the same approach to setting standing offer rates for two-period time of use tariffs as we did in our 1 January 2022 Victorian Default Offer price determination.[79] Under this approach, we align the tariff structures with the underlying two-period time of use network tariffs.

Stakeholders generally supported our approach to two-period time of use tariffs as described in our 2021 amended determination, and did not raise any issues during our 1 January 2022 Victorian Default Offer review and our draft decision on the 2022–23 Victorian Default Offer, that caused us to change our approach. [80]

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.

[79] Essential Services Commission, 1 January 2022 Victorian Default Offer price determination: November 2021.

[80] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, p.11.

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 final decision is to keep our approach to the compliant maximum annual bill amount

In addition to setting the flat and two-period time of use tariffs described, our final decision is to regulate all other standing offers (for example, non-standard time of use and demand tariffs) through a compliant maximum annual bill amount. 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 1 January 2022 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 amount at a specific usage amount (annual reference consumption 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.

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 3 and 4 below
- two-period time of use tariffs determined by the commission for each distribution zone.

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 retained the usage profiles for calculating the compliant maximum annual bill amounts for the 2022–23 Victorian Default Offer final decision. The usage profiles in tables 3 and 4 are based on the load data for the 2021 calendar year. We used manually read interval meter data provided by the Australian Energy Market Operator to calculate these profiles.

Table 3: 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

Note: All times are in local time

Table 4: 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

Note: All times are in local time

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.

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

In making a Victorian Default Offer price determination we must adopt an approach and methodology in accordance with section 33(2) of the *Essential Services Commission Act 2001 (Vic)* (ESC Act), and the pricing order.[81] Taken together, this means we must adopt an approach and methodology that best meets the objectives specified in the ESC Act, the commission's objectives under the *Electricity Industry Act 2000 (Vic)* and the objective of the Victorian Default Offer.[82]

Further, the Victorian Default Offer price determination must be based on the efficient costs of the sale of electricity by a retailer,[83] having regard to:[84]

- wholesale electricity costs
- network costs
- environmental costs
- retail operating costs, including only modest costs of customer acquisition and retention[85]
- retail operating margin[86]
- any other costs, matters or things we consider appropriate or relevant.

The pricing order also specifies that we must not include headroom.[87]

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[81] Clause 12(1) of the pricing order.

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

[83] 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.

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

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

[86] 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.

[87] 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.'

Our objectives in setting the Victorian Default Offer

As specified in the pricing order, 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.[88]

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. As objectives of the Electricity Industry Act 2000 (Vic), 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).

Without derogating from these objectives and the matters to which regard must be had under section 8A of the ESC Act, the commission must also when performing its functions and exercising its powers do so in a manner that the commission considers best achieves any objectives specified in the empowering instrument, in this case the pricing order.

In making a price determination, the commission must adopt an approach and methodology which the commission considers will best meet the objectives specified in the ESC Act and any relevant legislation. Section 33(5) of the ESC Act further states that a price determination by the commission may regulate a prescribed price for prescribed goods and services in any manner the commission considers appropriate.

Other factors the commission must have regard to

Section 8A of the ESC Act provides that in seeking to achieve the commission's objective 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

[88] 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 of the ESC Act applies to the extent it is not contrary to the pricing order.[89] Section 33(2) of the ESC Act provides that in making a price determination, the commission must adopt an approach and methodology which the commission considers will best meet the objectives specified in the ESC Act and the Electricity Industry Act.[90]

Section 33(3) of the ESC Act specifies that in making a determination 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.[91]

[89] Clause 12(12) of the pricing order.

[90] Section 33(2) of the ESC Act. The section refers to 'relevant legislation', which in this circumstance means the Electricity Industry Act.

[91] 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

Victorian Government Gazette

No. S 208 Thursday 30 May 2019

By Authority of Victorian Government Printer

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

1. Purpose

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

2. Commencement

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

3. Objective of the Victorian default offer

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

4. Definitions

1. In this Order:

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

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

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

Example: A storage water heater is such an appliance.

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

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

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

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

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

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

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

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

(a) the time of day;

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

(c) temperature, whether actual or forecast; or

(d) other characteristics that vary during the day.

Notes:

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

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

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

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

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

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

kWh means kilowatt hour;

Minister means the Minister administering the Act;

MWh means megawatt hour;

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

Order means this Order;

prescribed customer: see clause 5;

quarter means a period of 3 consecutive months;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2. Despite subclause (1), in:

(a) clause 6;
(b) clause 7;
(c) clause 10(2)(a)(i),
(d) schedule 1; and
(e) schedule 2,

the following definitions instead apply:

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

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

Notes:

1. The following terms are defined in section 3 of the Act: Commission; domestic or small business customer; distribution company; electricity bill; regulated tariff standing offer; retailer; standing offer.
2. As at the date of the commencement of this Order, the Order in Council made under section 35 of the Act and published in the Government Gazette No. S 315 on 25 November 2008 applies for the purposes of the definition of 'domestic or small business customer' in the Act.
3. 'price determination' is defined in section 13(6) of the Act.

5. Declaration of Prescribed customers

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

(a) a domestic or small business customer;

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

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

6. Victorian default offer tariffs

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

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

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

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

(a) a flat tariff; or

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

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

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

7. Retailer must make Victorian default offer

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

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

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

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

must be:

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

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

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

(a) are not flat tariffs; or

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

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

8. Information about the VDO on electricity bills

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

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

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

9. Conferral of functions and powers on the Commission

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

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

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

10. Commission to make VDO price determination

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

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

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

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

(a) must determine:

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

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

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

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

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

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

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

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

11. Regulatory periods for VDO price determinations

1. The first regulatory period commences on 1 January 2020.

2. Subject to subclause (3), the duration of each regulatory period is 12 months.

3. Before the commencement of a regulatory period, if the Commission considers that special circumstances exist, the Commission may, after consulting the Minister:

(a) extend the duration of the regulatory period by up to 6 months; or

(b) reduce the duration of the regulatory period, provided the duration of the regulatory period as so reduced is not less than 6 months.

12. Approach and methodology for making a VDO price determination

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

Note: section 33(2) of the ESC Act requires the Commission to adopt an approach and methodology that best meets the objectives of the ESC Act and of the **Electricity Industry Act 2000.**

2. In addition, the Commission must adopt an approach and methodology which the Commission considers will best meet the objective of the Victorian default offer.

3. The tariffs determined by the Commission pursuant to the VDO price determination are to be based on the efficient costs of the sale of electricity by a retailer.

4. For the purposes of subclause (3), the Commission must have regard to:

(a) wholesale electricity costs;

(b) network costs;

(c) environmental costs;

retail operating costs, including modest costs of customer acquisition and retention;

(d) retail operating margin; and

(e) subject to subclause (10), any other costs, matters or things the Commission, in the exercise of its discretion, considers appropriate or relevant.

Note: Section 33(3)(e) of the ESC Act similarly requires the Commission to have regard to any other factors that it considers relevant.

5. The VDO compliant maximum annual bill must be based on:

(a) the standing offer tariffs that the Commission determines are to apply in respect of flat tariffs; and

(b) the prescribed customer's electricity usage.

6. For the purposes of subclause (4)(d), the Commission must, in the exercise of its discretion, determine the amount of modest costs of customer acquisition and retention.

7. For the purposes of subclause (4)(e), the Commission must, in the exercise of its discretion, determine a maximum retail operating margin, and in doing so must have regard to (without limitation) the principle that the margin must not compensate retailers for risks that are compensated elsewhere in the costs.

8. Subclauses (3), (4), (5) and (6) do not require the Commission to determine tariffs based on the actual costs of a retailer.

9. Subclause (7) does not require the Commission to determine tariffs based on the actual retail operating margin of a retailer.

10. In making a VDO price determination the Commission must not include headroom.

11. Section 33(4)(a) of the ESC Act does not apply to the making of a VDO price determination.

12. Otherwise, section 33 of the ESC Act applies to the making of a VDO price determination only to the extent that the section is not contrary to this Order.

Notes:

1. This Order, as an 'empowering instrument' in terms of the ESC Act, can modify the application of section 33 of the ESC Act: see section 33(1) of the ESC Act.

2. Pursuant to section 33(3)(d) of the ESC Act, the Commission must have regard to relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries.

13. **Variation of VDO price determinations**

1. Before or during a regulatory period, the Commission may, on its own initiative, vary a VDO price determination in respect of the regulatory period.

2. The Commission must specify, in a VDO price determination, the circumstances under which the Commission will consider, and the basis on which the Commission will decide on, a proposed variation and (subject to subclauses (4) and (5)) the processes to be followed to enable the Commission to make such a variation.

3. Without limiting subclause (1), the Commission may vary a VDO price determination:

(a) if an event has occurred or will occur that was uncertain or unforeseen by the Commission at the time of making the VDO price determination; or

(b) to correct a clerical error, miscalculation, misdescription or other deficiency.

4. Before making a variation, the Commission must consult in accordance with clause 14.

5. Subclause (4) does not apply if:

(a) the variation is not sufficiently material to warrant consultation in accordance with clause 14; or

(a) the need for the variation is sufficiently urgent to warrant consultation in accordance with clause 14 not being undertaken.

6. If, as a result of a variation of a VDO price determination, a retailer is or will be required to vary the retailer's standing offer tariffs, the Commission must ensure the retailer is given adequate notice before the variation to the VDO price determination takes effect.

14. **Consultation**

1. The Commission may decide the nature and extent of stakeholder consultation it will undertake when making a VDO price determination or a decision to vary a VDO price determination.

2. For the purposes of subclause (1), the Commission must have regard to its Charter of Consultation and Regulatory Practice (as amended from time to time) developed and published under section 14 of the ESC Act.

15. **Victorian default offer tariffs to be the reference tariffs for discounts**

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

Provided that, if those amendments do not provide for any matter provided for in this clause, then this clause continues to apply in respect of that matter.

2. A retailer that offers a discount to a domestic customer or a small business customer must:

(a) if the discount is in respect of the period from 1 July 2019 to 31 December 2019, disclose how the discount is calculated as against the tariffs in Schedule 1 or Schedule 2 (as the case may be), and what (in percentage or dollar terms) the reduction in tariff is in terms of those tariffs; and

(b) if the discount is in respect of a regulatory period, disclose how the discount is calculated as against the flat tariffs determined by the Commission pursuant to the VDO price determination that applies in respect of that period, and what (in percentage or dollar terms) the reduction in tariffs is in terms of those tariffs.

3. For the purposes of subclause (2), the reduction in tariffs is to be expressed as the difference between the estimated annual cost of the Victorian default offer for the customer type and distribution zone, and the estimated annual cost of the offer to which the discount relates after the discount is applied, using the annual reference consumption.

4. For the purposes of subclause (3):

(a) the estimated annual cost of the Victorian default offer is:

i. during the period from 1 July 2019 to 31 December 2019, determined by applying Schedule 3;

ii. during a regulatory period, determined by applying Schedule 3 or any other approach or methodology determined by the Commission; and

(b) the retailer must determine the estimated annual cost of the retailer's offer to which the discount relates:

i. if the tariff is a flat tariff or a flexible tariff (in either case, with or without a controlled load), by applying Schedule 3;

ii. otherwise, based on a reasonable estimate having regard to any relevant information available to the retailer; and

5. The annual reference consumption is:

(a) during the period from 1 July 2019 to 31 December 2019:

i. for domestic customers without a controlled load – 4,000 kWh general usage per annum;

ii. for domestic customers with a controlled load – 4,000 kWh general usage plus 2,000 kWh controlled load usage per annum;

iii. for small business customers (with or without a controlled load) – 20,000 kWh general usage per annum.

(b) during a regulatory period:

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

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

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

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

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

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

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

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

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

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

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

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

i. all offers of discounts by retailers; and

ii. the advertising in respect of those discounts.

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

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

i. the discounted tariffs offered by a retailer; and

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

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

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

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

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

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

SCHEDULE 1

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

Charges are inclusive of GST.

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

SCHEDULE 2

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

Charges are inclusive of GST.

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

SCHEDULE 3

1. Estimated annual cost for flat tariff offers

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

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

where:

EAC is the estimated annual cost of the offer;

SC is the supply charge;

UC is the general usage charge; and

ARC is the annual reference consumption for general usage.

2. Estimated annual cost for flexible tariff offers

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

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

where:

EAC is the estimated annual cost of the offer;

SC is the supply charge; and

ARC is the annual reference consumption for general usage;

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

UC_P is the retailer's peak usage charge;

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

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

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

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

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

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

where:

EAC is the estimated annual cost of the offer;

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

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

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

Table 1 – Usage allocation for flexible tariffs

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

Dated 28 May 2019 Responsible Minister

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

PIETA TAVROU

Clerk of the Executive Council

Electricity Industry Act 2000

MINISTERIAL ORDER UNDER SECTION 35(3B)

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

1. Commencement

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

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

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

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

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

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

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

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

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

4. Expiry of this Order

This Order expires on 31 March 2020.

Dated 22 May 2019

HON. LILY D'AMBROSIO MP

Minister for Energy, Environment and Climate Change

Appendix 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

Appendix D: Calculation of the cost stack

This appendix provides a summary of the key figures required to understand our final 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 2022-23 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 2022–23 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 2022–23 ($/MWh, nominal, GST exclusive)

Distribution zone	Domestic		Small business	
	Wholesale price	Volatility adjustment	Wholesale price	Volatility adjustment
AusNet Services	$81.46	$0.38	$70.17	$0.44
CitiPower	$76.56	$0.40	$70.16	$0.50
Jemena	$81.82	$0.39	$68.78	$0.55
Powercor	$80.25	$0.46	$69.63	$0.44
United Energy	$81.03	$0.48	$68.95	$0.59

Source: Frontier Economics, Wholesale electricity costs for 2022-23: A final report for the Essential Services Commission, May 2022.

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 total loss factor based on the 2022-23 distribution and marginal loss factors published by Australia Energy Market Operator (see table D.2).[92]

Table D.2: Network losses for 2022-23

Distribution zone	Distribution loss factor (DLF)	Marginal loss factor (MLF)	Total loss factor
AusNet Services	1.0768	1.0021	7.91%
CitiPower	1.0488	0.9979	4.66%
Jemena	1.0379	0.9998	3.77%
Powercor	1.0776	0.9925	6.95%
United Energy	1.0471	0.9968	4.37%

Source: Australian Energy Market Operator, Distribution Loss Factors and Marginal Loss Factors 2022-23

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 Australian Energy Regulator approved flat network tariffs for the period 1 July 2022 to 30 June 2023 for the purposes of our final decision.

Table D.3 Domestic electricity network charges, flat tariff, 2022–23 (GST exclusive)

Distribution zone	Daily charge ($ per year)	Variable charge structure	Variable charge ($ per kWh)	Controlled load ($ per kWh)
AusNet Services	$125.07	Block 1 Block 2	$0.1272 $0.1424	$0.0475
CitiPower	$90.01	Anytime	$0.0740	$0.0222
Jemena	$89.69	Anytime	$0.0825	$0.0345
Powercor	$139.98	Anytime	$0.0815	$0.0235
United Energy	$85.01	Anytime	$0.0830	$0.0234

Source: Victorian distribution businesses' Australian Energy Regulator approved 2022–23 pricing proposals.

[92] Australian Energy Market Operator, Distribution Loss Factors for the 2022-23 Financial Year, April 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, Marginal Loss Factors for the 2022-23 Financial Year, April 2022, pp. 23-28.

Table D.4 Small business electricity network charges, flat tariff, 2022–23 (GST exclusive)

Distribution zone	Daily charge ($ per year)	Variable charge structure	Variable charge ($ per kWh)
AusNet Services	$125.07	Block 1 Block 2	$0.1750 $0.2054
CitiPower	$160.02	Anytime	$0.0803
Jemena	$136.95	Anytime	$0.1084
Powercor	$179.98	Anytime	$0.0929
United Energy	$130.01	Anytime	$0.0914

Source: Victorian distribution businesses' Australian Energy Regulator approved 2022–23 pricing proposals.

Tables D.5 and D.6 show the Australian Energy Regulator approved two-period network tariffs for the period 1 July 2022 to 30 June 2023, used in the final decision.

Table D.5 Domestic electricity network charges, two-period time of use network tariffs, 2022–23 (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	$125.07	$0.2291	$0.0477	$0.0475
CitiPower	$90.01	$0.1470	$0.0367	$0.0222
Jemena	$89.69	$0.1378	$0.0398	$0.0345
Powercor	$139.98	$0.1617	$0.0405	$0.0235
United Energy	$85.01	$0.1622	$0.0405	$0.0234

Source: Victorian distribution businesses' Australian Energy Regulator approved 2022–23 pricing proposals.

Table D.6 Small business electricity network charges, two-period time of use network tariffs 2022–23 (GST exclusive)

Distribution zone	Daily charge ($ per year)	Peak variable charge ($ per kWh)	Off-peak variable charge ($ per kWh)
AusNet Services	$125.07	$0.1932	$0.0471
CitiPower	$160.02	$0.1333	$0.0296
Jemena	$244.18	$0.1410	$0.0295
Powercor	$179.98	$0.1619	$0.0359

United Energy	$130.01	$0.1498	$0.0333

Source: Victorian distribution businesses' Australian Energy Regulator approved 2022–23 pricing proposals.

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, used in the final decision.

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

Distribution business	Annual metering charge ($ per customer)
AusNet Services	$73.69
CitiPower	$65.84
Jemena	$64.71
Powercor	$62.15
United Energy	$43.60

Source: Victorian distribution businesses' Australian Energy Regulator approved 2022–23 pricing proposals.

Environmental scheme costs

Large-scale Renewable Energy Target costs

Under the Large-scale Renewable Energy Target scheme, the liability percentage is called the renewable power percentage. The Clean Energy Regulator has set the 2022 renewable power percentage (18.64 per cent), under current targets this will not change for the duration of the program. We calculate the 12 month average of forward market prices for financial year 2022-23 large-scale generation certificates as reported by Demand Manager.[93]

Small-scale Renewable Energy Scheme costs

The liability percentage under the Small-scale Renewable Energy Scheme is called the small-scale technology percentage. The federal Clean Energy Regulator has published the binding small-scale technology percentage for 2022. We used the mid-point between the 2022 binding and 2023 non-binding small-scale technology percentage to calculate the liability for this decision.[94]

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.

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[93] Demand Manager, Certificate prices, accessed 14 April 2022, http://demandmanager.com.au/certificate-prices.

[94] Clean Energy Regulator, The small-scale technology percentage, accessed 18 March 2022, The small-scale technology percentage (cleanenergyregulator.gov.au).

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 2022. As the greenhouse gas reduction rate for 2023 was not available at the time of our final decision, we used the 2022 rate of 0.16113. 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 11 April 2022, we estimated an average price of $73.62 per certificate for the final decision. Our estimate of the per megawatt hour Victorian Energy Upgrade Costs for the final decision is $11.86, which is higher than the estimate used in the 1 January 2022 Victorian Default Offer.

Feed-in Tariff (social cost of carbon)

For the final decision, the impact of the feed-in tariff on retailer costs is based on total small-scale renewable exports in the most recently available 12 month period[95] multiplied by the social cost of carbon (2.5 cents per kWh for 2022-23). 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	$35.46	18.64%	$6.61
Small-scale Renewable Energy Scheme	$40.00	24.8%	$9.92
Victorian Energy Upgrades	$73.62	16.11%	$11.86
Feed-in Tariff (social cost of carbon)			$16.38/customer
Small-scale Renewable Energy Scheme true up adjustment (GST inclusive)			$0.82
Large-scale Renewable Energy Target true up adjustment (GST inclusive)			$0.04

Source: ESC analysis and Frontier Economics, Wholesale electricity costs for 2022-23: A final report for the Essential Services Commission, May 2022, pp. 54-55.

[95] Total solar exports from 1 March 2021 to 28 February 2022

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

Based on our updated benchmarks, we used a benchmark of $146.35 excluding GST for retail operating costs and $41.01 excluding GST for customer acquisition and retention costs (see table D.9).

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	$146.35
Customer acquisition and retention costs	$41.01
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 draft Budget and Fees.[96] The estimate of our licence fee is a market-wide average based on the approved fees for the year 2020-21, 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	$0.75/MWh
Full retail contestability	$1.31/customer

[96] Australian Energy Market Operator, Presentation to Finance Consultation Committee, Draft FY23 Budget & Fees, March 2022

Charge	Rate
National Transmission Planner fees	$0.00/MWh
IT Upgrade and Five-minute and global settlement compliance fees	$0.21/MWh
Distributed energy resources integration program fees	$0.02/MWh
Energy Consumers Australia fees	$0.57/customer
Ancillary services	$0.35/MWh
Reliability and Emergency Reserve Trader	$0.00/customer
Total per MWh:	**$1.34/MWh**
Total per customer:	**$4.12/customer**[97]

[97] 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 final decision on the 2022–23 Victorian Default Offer, we have built on our 1 January 2022 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 1 January 2022 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 collected cost data from electricity retailers during the 2022-23 Victorian Default Offer review. 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 final decision for the 2022-23 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 2022–23.

Our approach and methodology include these elements to estimate the efficient costs of the sale of electricity by a retailer:[98]

[98] 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 on benchmarks from previous regulatory decisions
- **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 final decision and price determination to account for any changes in market data that occurred after our draft decision. The data provided by retailers was used 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.[99]

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 retail operating costs, after taking into account the additional cost claims by retailers. In considering this information we have had regard to our statutory objectives, including the financial viability of the retail energy market and promoting full retail competition.

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

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.[100] We also consider this arrangement provides a framework that does not impose unreasonable costs on retailers.[101] 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.[102]

Our assessment approach helps us meet our legislative requirements

Our assessment approach helps us meet our objectives

In setting the Victorian Default Offer our objectives are to:

- provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.[103]
- promote the long-term interests of Victorian consumers. In seeking to achieve this objective we must have regard to the price, quality and reliability of essential services. [104]

In terms of promoting the development of full retail competition, the Victorian Default Offer does not prevent customers from choosing their electricity retailer. As retailers will still be free to compete for customers in the market by making offers above and below the Victorian Default Offer, we note that our approach to the Victorian Default Offer is consistent with the objective in the Electricity Industry Act relating to full retail competition.

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[100] Section 10(c) of the Electricity Industry Act.

[101] Section 8A(1)(e) of the ESC Act.

[102] Section 8A(1)(f) of the ESC Act.

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

[104] Section 8 of the ESC Act.

Having regard to the relevant matters under the ESC Act

In making our determination, we must have regard to a number of matters to the extent that they are relevant.[105] We have had regard to all of these matters in coming to our final decision.

Efficiency

Efficiency is an important consideration for our decision.[106] 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.[107] Our review used largely the same approach as our 1 January 2022 price determination.

Financial viability

A related matter is the consideration of long-term incentives for investment and financial viability.[108] As our final 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.[109]

The relevant legislation applying to the industry

We considered other legislation that affects the efficient costs of a retailer.[110] 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, 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 Australian retailers complying with regulatory and legislative requirements.

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[105] Sections 8A and 33(3) of the ESC Act.

[106] Section 8A(1)(a) and 33(3)(b) of the ESC Act 2001.

[107] Section 33(3)(c) of the ESC Act; clause 12(4)(e) of the pricing order.

[108] Section 8A(1)(b) of the ESC Act.

[109] Section 8A(1)(c) of the ESC Act.

[110] Section 8A(1)(d) of the ESC Act.

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.[111] In formulating the Victorian Default Offer we are not required to revisit the costs and benefits of implementing the Victorian Default Offer.[112]

We have, however, had regard to the costs and benefits of regulation in our approach to formulating the Victorian Default Offer.[113] The Victorian Default Offer reflects a price that is based on the efficient costs of providing retail electricity services. The efficient cost and its interrelationship with the costs and benefits of regulation have been considered throughout our final decision. Further, in consulting with stakeholders, we considered the information presented to us and noted we would require strong new evidence to change our approach for most cost items. In using this already established approach we sought to minimise the amount of change and regulatory burden for stakeholders.

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 State jurisdictions. In considering benchmarks from other jurisdictions we also had regard to the different policy intent of the relevant legislation.[114]

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.[115] We also had regard to actual cost data from retailers. We also considered the broader economic environment including the impact of the pandemic on retailers' costs. We have also included an additional amount in our benchmarking of retail operating costs to cover differences in regulation between Victoria and other parts of Australia.

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[111] 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.

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

[113] Section 8A(1)(e) of the ESC Act.

[114] Section 8A(1)(f) and 33(3)(d) of the ESC Act.

[115] Section 8A(1)(e) of the ESC Act.

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.[116] 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 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.

Having regard to the other relevant matters the pricing order

Clause 12 of the pricing order provides guidance on the approach and methodology for making a Victorian Default Offer price determination. We considered this guidance in making our final decision. The relevant matters are considered in the body of our final decision including the cost stack chapter, chapter on flat tariffs and maximum bill, and earlier in this appendix.

[116] Section 33(4)(b) of the ESC Act.

Appendix F: Stakeholder submissions on draft decision

Name of organisation	Date received
Consumer Action Law Centre	8 April 2022
Momentum Energy	11 April 2022
AGL	12 April 2022
Alinta Energy	12 April 2022
EnergyAustralia	12 April 2022
Energy Consumers Australia	12 April 2022
Origin Energy	12 April 2022
ReAmped Energy	12 April 2022
Red Energy and Lumo Energy	12 April 2022
Simply Energy	12 April 2022
Victorian Council of Social Service	12 April 2022

Appendix G: Changes to cost benchmarks

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

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

Item	1 January 2022 Victorian Default Offer final decision	2022–23 Victorian Default Offer final decision
Victorian Default Offer costs		
Wholesale electricity costs	Estimated based on a 12-month trade weighted average of future contract prices from ASX Energy. Demand and relationship between demand and price estimated in a Monte-Carlo simulation using 5 years of data. Used the weighted average of the short and long sub-transmission factors for calculating distribution losses to apply to both AusNet Services and Powercor regions. Removed some transmission nodes that do not have residential or small business load in calculating the marginal loss factor.	No change in approach but the Monte Carlo simulation to forecast demand, and the relationship between demand and price, now only uses 3 years of historical data. Costs updated for most recent contract information (6 May 2022) closer to the publication of the decision only for this decision.
Network costs	Australian Energy Regulator's approved network tariffs are treated as pass through costs. Metering costs based on lowest cost service available. Included a true-up for under or over recovered network costs from July and August 2021.	No change in overall approach. Metering costs based on customer weighted average metering costs. True-up for under or over recovered network costs from July and August 2021 does not apply.
Environmental costs		
Large-scale Renewable Energy Target	Estimated based on the 2022 default renewable power	No change in approach

Item	1 January 2022 Victorian Default Offer final decision	2022–23 Victorian Default Offer final decision
	percentage (calculated using the Clean Energy Regulator's outlined methodology) multiplied by the futures market price for large-scale certificates.	
Small-scale Renewable Energy Scheme	Estimated based on mid-point of the 2022 non-binding small-scale technology percentage and the 2021 binding small-scale technology percentage, multiplied by the clearing house price. 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 2021.	No change in approach
Victorian Energy Upgrades	Estimated based on the 2021 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 2022 greenhouse reduction rate.
Minimum feed-in tariff (social costs of carbon)	Estimated based on total renewable exports in 2020–21 divided by average total domestic and small business customers in 2020–21, multiplied by the social cost of carbon of 2.5 cents per kWh.	No change in approach
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. Benchmark also includes $10 for additional regulatory costs specific to Victoria and a small annual amount of $0.84 for the ongoing operating expenditure	No change in approach

Item	1 January 2022 Victorian Default Offer final decision	2022–23 Victorian Default Offer final decision
	associated with five-minute settlement. The $6 temporary adjustment for bad debts was removed in the 1 January 2022 Victorian Default Offer.	
Customer acquisition and retention costs	Estimated based on cost levels from the Australian Competition and Consumer Commission's retail and electricity pricing inquiry's final report updated for inflation.[117]	No change in approach
Other costs	Estimated and updated based on the latest available information on the: Australian Energy Market Operator's 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.	No change in approach.
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	6 months	12 months

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

Table G.2: Changes in average residential costs benchmarks, $ nominal, inclusive of GST

Item	1 January 2022 Victorian Default Offer final decision	2022–23 Victorian Default Offer final decision
Wholesale electricity costs	$303	$340
Network costs	$523	$527
Environmental costs	$138	$138
Retail operating costs (including acquisition costs)	$181	$187
GST	$120	$127
Retail operating margin	$68	$73
Other costs	$8	$10

Table G.3: Updates to the draft decision

Cost item	Draft decision	Final decision
Key updates		
Network costs	• Network tariffs used in the 2022 Victorian Default Offer	• Updated network and metering tariffs published on the Australian Energy Regulator website • This has an impact of +$12 on an average residential Victorian Default Offer bill
Wholesale costs	• Contract price and volume information updated for draft decision	• Contract price and volume information updated for final decision • This has an impact of +$20 on an average residential Victorian Default Offer bill
Retail costs	• Cost benchmarks adjusted for Consumer Price Index for December 2021	• Cost benchmarks adjusted for Consumer Price Index for quarter ending March 2022 • This has an impact of +$4 on an average residential Victorian Default Offer bill
Other costs	• Final Australian Energy Market Operator fees for 2021-22, escalated by Consumer Price Index	• Draft Australian Energy Market Operator fees for 2022-23 • This has an impact of +$2 on an average residential Victorian Default Offer bill
Other updates		
Other costs that were updated for latest available information were:		

- Large scale Renewable Energy Target updated for the latest Large-scale Generation Certificate price information
- Victoria Energy Upgrade costs updated for the latest Victorian Energy Efficiency Certificate price information
- Feed-in tariff costs updated for the latest solar export data from 1 March 2021 to 28 February 2022
- Network losses updated for the latest Distribution Loss Factors and Marginal Loss Factors
- Ancillary charges updated for the latest ancillary charge information
- These updates had a combined impact of +$2 on an average residential Victorian Default Offer bill