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11 April 2023

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

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

Dear Ms Symons,

**Re: Draft determination: Victorian Default Offer for 2023–24**

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to comment on the Essential Services Commission's (the Commission's) draft determination for the Victorian Default Offer (VDO) to apply from 1 July 2023.

The Commission proposes a significant increase in the level of the VDO, which is primarily due to unprecedented supply challenges and volatility in the wholesale market. These same factors are impacting retailers' cost structures. We are very mindful of the consumer impact, particularly for those experiencing payment difficulties and this highlights the importance of the Payment Difficulty Framework (PDF). This Framework is directly targeted at such consumers and is a proportionate regulatory measure. Both the VDO and PDF are key components of the broader regulatory framework.

The Commission is aware that the VDO functions as both a reference price for all consumers and a fair price for those unwilling to participate in the competitive retail market. It is also intended to allow retailers to recover efficient costs. As such, the VDO cannot insulate consumers from the impact of increasing costs that are caused by underlying structural factors. Suppressing the VDO to address concerns about vulnerability would further erode retail margins, which the Australian Competition and Consumer Commission notes are at historically low levels, and threaten retailer viability.<sup>1</sup> As the events of 2022 show, retailer failures cause significant disruption for impacted consumers.

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

The Commission should retain its commitment to good regulatory practice in its VDO determinations. For this to occur, the Commission must ensure that its decisions reflect stable, predictable, and consistent methodologies. At the same time, the Commission should look for opportunities to improve its methodology when it is clear that a better approach exists or when better data becomes available, and following extensive stakeholder consultation. The Commission has largely retained its established methodology for the draft VDO determination and we encourage it to do so for the final determination.

### **Wholesale costs**

Red and Lumo support the Commission's methodology for estimating wholesale electricity costs, which uses trade weighted contract prices from the last twelve months to develop a wholesale cost benchmark. The relatively short hedging period—compared to the Default Market Offer, for example—means this component necessarily places greater weighting on more recent wholesale market outcomes. In this case, this means the energy crisis of 2022 and its lingering impact. However, these fluctuations have been a feature of the VDO since its implementation, both when wholesale costs have increased and when they have fallen.

The Commission's determination of wholesale electricity purchase costs should always be based on a stable, consistent and predictable methodology. This is critical to maintaining retailers' confidence in their ability to recover costs. Furthermore, any differences between actual and estimated costs for any specific retailer that reflects its individual hedging strategy will smooth out over time if this consistency is maintained. As a result, we would not support any short term adjustment to the VDO draft determination to manage higher wholesale costs that are not applied in a symmetrical way.

### **Market intervention costs**

Red and Lumo recommend the Commission consider the inclusion of an allowance to account for generator compensation costs that the Australian Energy Market Commission (AEMC) hasn't calculated by the time of the Commission's final determination. We acknowledge that the draft determination has only included an allowance for 'known' compensation costs. However, we continue to recommend that the Commission liaise with the AEMC to understand the likely materiality of the costs that are yet to be calculated. Otherwise, smaller retailers will be exposed to significant costs during 2023/24 that they cannot recover, which could create liquidity challenges and undermine their viability.

## **Retail operating costs**

Red and Lumo recommend the Commission retain its current methodology for determining Retail Operating Costs for the next VDO, which relies on the benchmark set by the Independent Competition and Regulatory Commission in the Australian Capital Territory. The Commission has applied this methodology since the first determination and we recommend a consistent approach due to the ongoing instability and challenging environment for retailers operating in Victoria. We acknowledge the Commission's intention to calculate this component from actual cost data but a shift to a customer weighted average will favour larger retailers who are able to spread overheads and shared costs across a larger customer base. We recommend the Commission defer this change in methodology.

## **About Red and Lumo**

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

We thank the Commission for the opportunity to comment on the draft determination. Should you wish to discuss aspects of this submission or have any further enquiries, please contact Con Noutso Regulatory Manager on 0481 013 988.

Yours sincerely

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

**Geoff Hargreaves**  
Manager - Regulatory Affairs  
**Red Energy Pty Ltd**  
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