ESSENTIAL SERVICES COMMISSION

# 1 January 2022 Victorian Default Offer

Final decision

25 November 2021

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# Contents

# Our final decision lowers Victorian Default Offer prices

- Our final decision results in prices lower than current Victorian Default Offer prices. The average annual bill for residential customers on the Victorian Default Offer will be five per cent lower, with a six per cent fall for small business customers.
- This drop in prices is largely due to lower forecast wholesale electricity prices.
- Our final decision on Victorian Default Offer prices applies from 1 January 2022 to 30 June 2022.

The Victorian Default Offer was put in place by the Victorian Government on 30 May 2019 to regulate standing offer prices for electricity in Victoria.

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.

Although prices for standing offers are regulated, electricity retailers can and do supply electricity under market offers with prices that are different to standing offers.

## 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 the prices for standing offers.[1]

On 25 November 2020, we set Victorian Default Offer prices for calendar year 2021. We amended the 2021 Victorian Default Offer in September 2021 to account for changes to network tariffs.

[1] 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).

Under the pricing order, we must make a new determination for the Victorian Default Offer tariffs to apply from 1 January 2022. We must do so by 25 November 2021.

### The objective of the Victorian Default Offer and who it applies to

The Victorian Default Offer's objective is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity market.

The Victorian Default Offer is a set of prices that applies to all types of standing offers. Since 1 September 2020 the Victorian Default Offer has also applied as a maximum price for most embedded network customers. The Victorian Default Offer is also a reference price to help consumers compare market offers.

The Victorian Default Offer is generally available to domestic and small business customers. Around 200,000 households and 50,000 small businesses are on standing offers. This represents seven per cent of households and 16 per cent of small business customers. Victorian Default Offer prices are also a price cap for roughly 140,000 customers in embedded networks.

Customers may be able to get a better deal than the Victorian Default Offer.

For most customers, the Victorian Default Offer will not be the best offer available. Retailers must regularly tell customers whether they are on the retailer's best energy plan, and how much the customer could save by switching. Embedded networks may also offer prices below the Victorian Default Offer.

## We have made some small changes to our approach

In general, we have used the same approach to setting the 1 January 2022 Victorian Default Offer prices. The main change is that we have set the regulatory period to six months instead of one year. A 6-month regulatory period will provide the quickest alignment between Victorian Default Offer regulatory periods and network tariff regulatory periods. This will mean that the network costs included in the Victorian Default Offer prices will more accurately reflect retailers' actual costs sooner.

The other changes in this Victorian Default Offer are that we have:

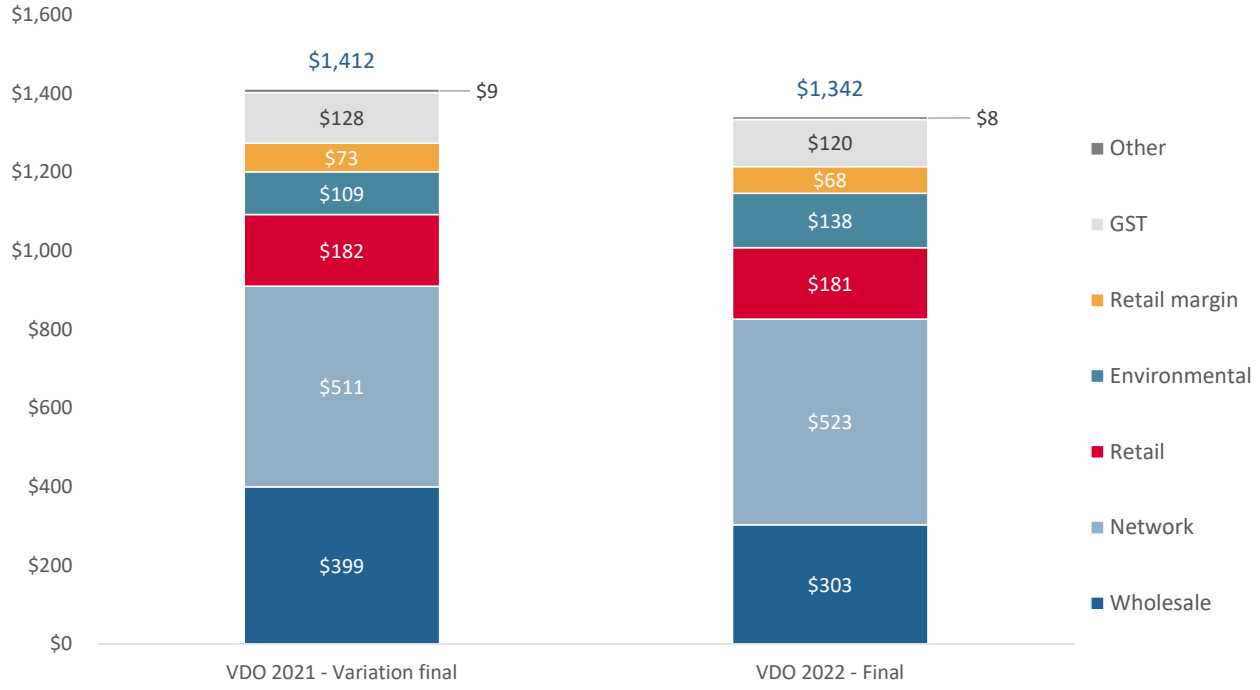
- removed the temporary adjustment for bad debts
- included a true-up for under or over recovered network costs
- made some small changes to distribution loss factors
- updated Australian Energy Market Operator fees.

More detail on these changes can be found in appendix G.

## Our final decision will lead to lower Victorian Default Offer prices

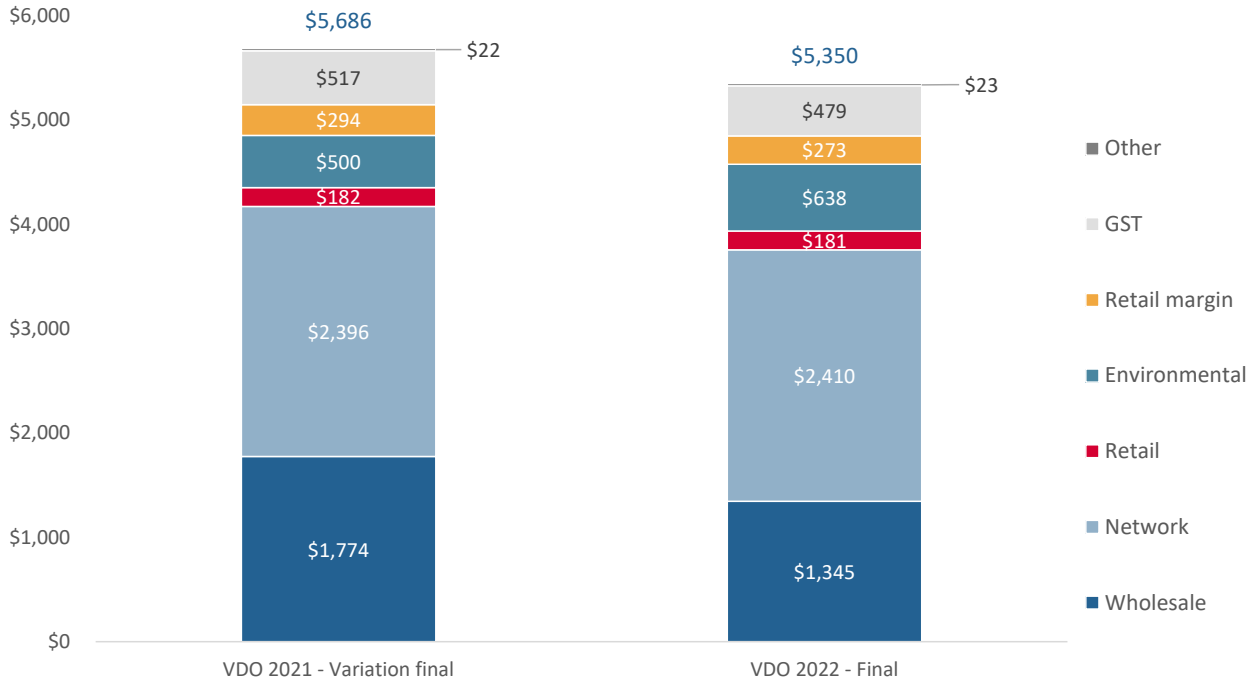
In making this decision, we have updated all of the inputs to our Victorian Default Offer pricing model. Using the most up to date market and regulatory data our Victorian Default Offer model shows that prices from 1 January 2022 should be lower. This is mainly driven by lower wholesale costs but slightly offset by higher environmental and network costs. Figures 1 and 2 below show the changes in the cost stacks between the amended 2021 Victorian Default Offer and the one to apply from 1 January 2022.[2] The average bill for residential customers in 2021 was $1,412. For 2022 it will be $1,342.

### Figure 1: Change in Victorian Default Offer annual bills for residential customers




[2] The commission amended the 2021 Victorian Default Offer in July 2021 to account for the network tariffs applying from 1 July 2021. The amended Victorian Default Offer Price Determination 2021 took effect on 1 September 2021.

## Figure 2: Change in Victorian Default Offer annual bills for small business customers




## We have kept our approach to wholesale costs

Our final decision uses the same approach to wholesale costs that we have used in past reviews. Of particular note we have used the average wholesale costs over a 12-month forecast period. We consider retaining this approach best meets our objectives, including consideration of the financial viability of the retail electricity sector, and is in the long term interests of Victorian consumers.

## We have removed the temporary adjustment for bad debts

The information available to us suggests that economic conditions will improve in 2022. Publicly available financial statements from retailers also show that there is no clear trend in the change in bad debts as a result of the pandemic.[3] As a result, we have removed the temporary adjustment for bad debts from the 1 January 2022 Victorian Default Offer cost stack.

[3] Origin Energy, 2021 Full Year Report: Where all good change starts, August 2021, pp. 24-25; Origin Energy, Annual Report: Financial Year 2020, pp. 31-32; Origin Energy, Annual Report: Financial Year 2019, pp. 35, 112; Origin Energy, Annual Report: Financial Year 2018, pp. 54, 117; AGL, Annual Report: Financial Year 2021, pp. 17, 37; AGL, Annual Report: Financial Year 2020, pp. 43, 108; AGL, Annual Report: Financial Year 2019, pp. 12, 47; AGL, Annual Report: Financial Year 2018, pp. 9, 87; Snowy Hydro, Snowy Hydro Limited Annual Report for the year ended 2021, pp. 4, 57-58; Snowy Hydro, Snowy Hydro Limited Annual Report for the year ended 2020, p. 7, 46; Snowy Hydro, Snowy Hydro Limited Annual Report for the year ended 2019, pp. 5, 43.

## We seek submissions on matters for the 2022-23 Victorian Default Offer

As the next Victorian Default Offer regulatory period will begin on 1 July 2022 we will need to complete our review by 24 May 2022. This requires a shorter consultation period than usual. To meet this need we will not publish a consultation paper and will start consulting on the 2022-23 Victorian Default Offer now. We are seeking submissions from stakeholders on any matters that we may need to take into consideration for the 2022-23 Victorian Default Offer.

Given these time constraints, and the well-established nature of our methodology, we anticipate that adopting an approach consistent with this decision will best meet our legislative objectives and requirements for the 2022-23 Victorian Default Offer. Noting that in setting prices for the 2022-23 Victorian Default Offer we will update our cost estimates to reflect changes in market-based data where relevant.

We welcome any new empirical evidence, or analysis of specific new market developments that could inform updating the now established approach for setting the Victorian Default Offer for 2022-23. Table 1 below provides indicative timelines for the next Victorian Default Offer review.

**Table 1: Timeframes for the 2022-23 Victorian Default Offer review**

| Key milestones | Indicative date |
|---|---|
| Initial submissions on the 2022-23 Victorian Default Offer close | 3 February 2022 |
| Draft decision on 2022-23 Victorian Default Offer released | Mid-March 2022 |
| Draft decision on 2022-23 Victorian Default Offer – public forum | Late March 2022 |
| Submissions 2022-23 Victorian Default Offer draft decision close | Early April 2022 |
| Final decision and final determination on Victorian Default Offer | By 24 May 2022 |

### How to provide feedback

General comments and formal submissions on key matters we should consider in the 2022-23 Victorian Default Offer should be made by **5pm 3 February 2022**.

We may place lower weight on, or may not be able to consider, submissions received after these dates.

To make a submission on the 2022-23 Victorian Default Offer please email us at: VDO@esc.vic.gov.au.

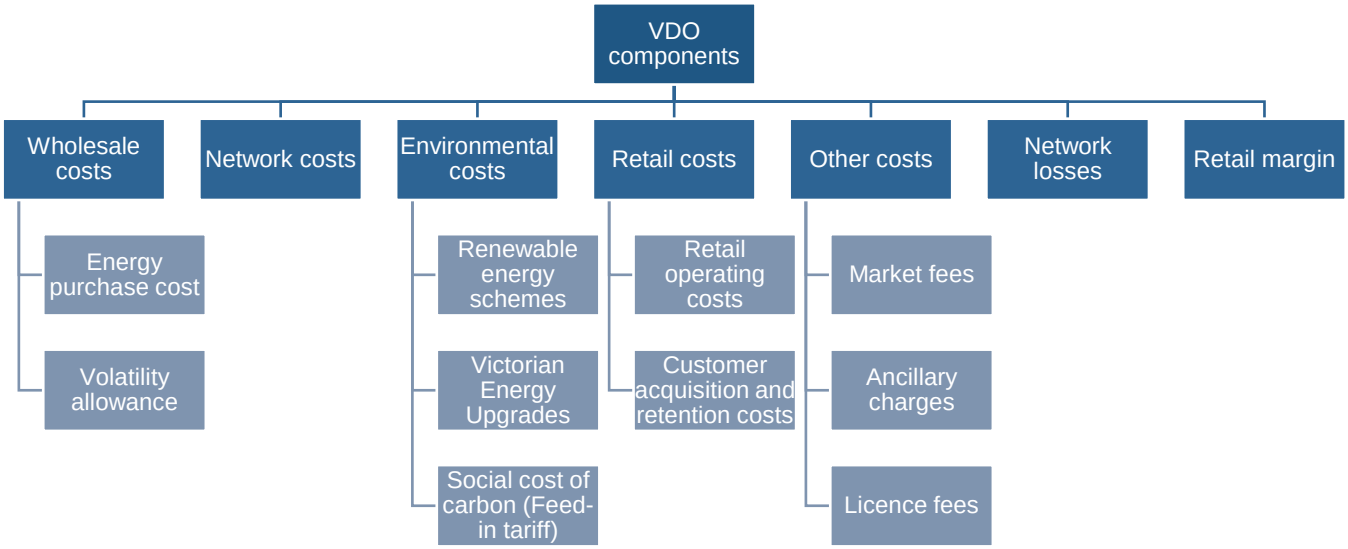
If this presents an issue, call us on 1300 664 969 to discuss other options for making a submission.

All submissions come under the commission's submissions policy. Submissions will be made available on the commission's website, except for any information that is commercially sensitive or confidential. Submissions should clearly identify which information is sensitive or confidential. View more information at www.esc.vic.gov.au/submissions.

# 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.[4] We are also required to have regard to a number of cost components in setting tariffs.[5] Figure 3 sets out the key items included in the Victorian Default Offer cost stack.

**Figure 3: 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 expected future electricity costs in the market
- network costs – taken directly 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 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 a comparable regulatory decision.

[4] Pricing Order clause 12(3).

[5] Pricing Order clause 12(4).

As part of this review we updated the estimates included in the cost stack to reflect changes in the market and new data.

We also undertook further analysis of our already established approach to determining Victorian Default Offer prices. For example, we reconsidered the retail margin and whether or not to include a productivity factor.

We also considered some short-term issues that may affect retailers' costs. These include the potential for increased bad debts due to the pandemic and network costs that retailers were unable to recover from consumers for the months of July and August 2021.

### The Victorian Default Offer will allow retailers to recover efficient costs

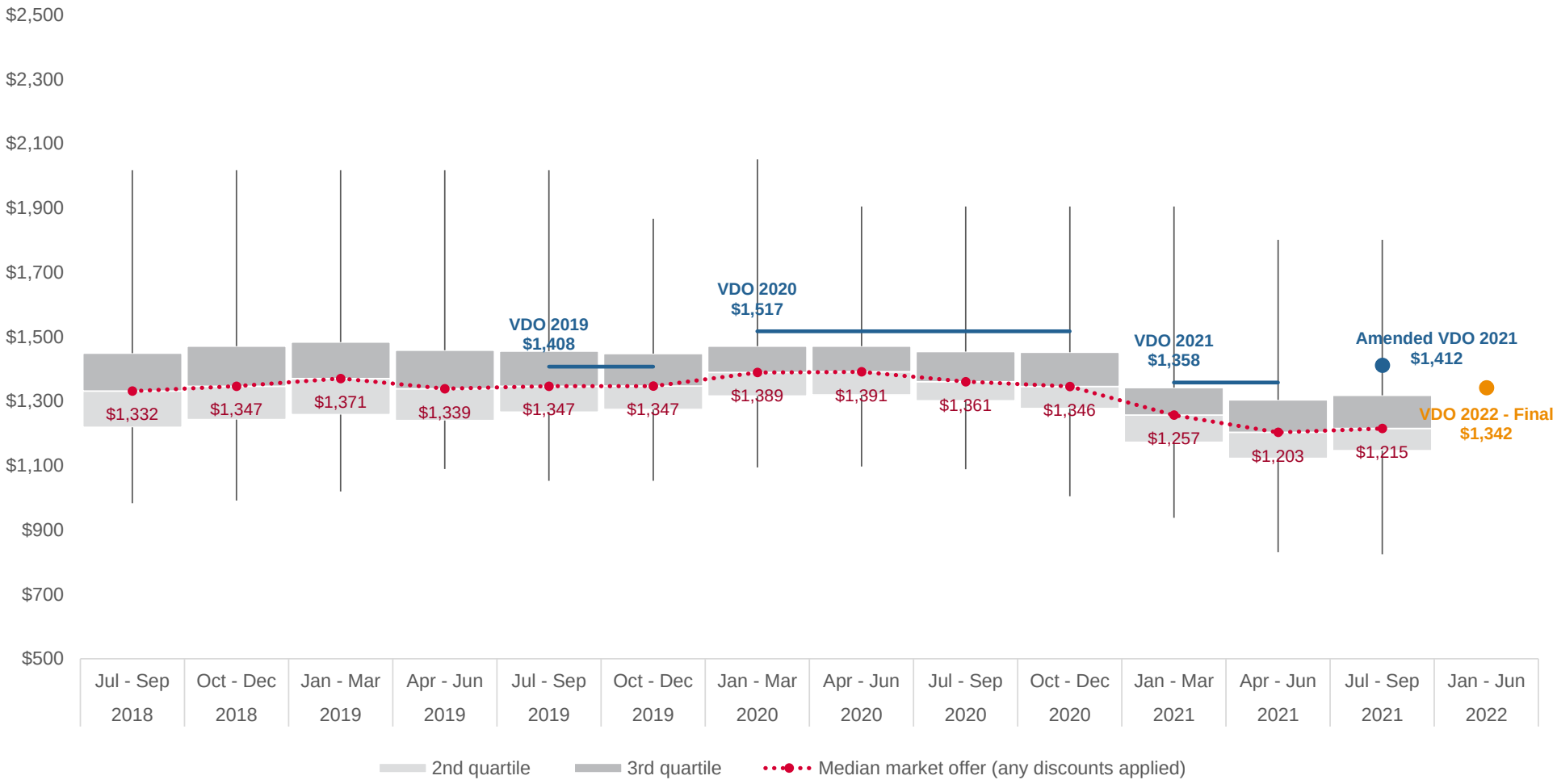
While we have regard to each cost component in setting tariffs, under the pricing order we must base tariffs on retailers' total costs.[6] Further, we are not required to set tariffs on the basis of the actual costs of a retailer.[7] As a result the Victorian Default Offer prices and the benchmark for individual cost components may differ to retailers' actual costs.

However, as a cross-check of our cost stack we have looked at actual cost data provided to us by retailers. The Victorian Default Offer prices fall within the range of retailers' observed total costs. This suggests that our methodology allows retailers to recover at least their efficient costs. This is further supported by the fact that most market offers are below the average Victorian Default Offer bill (as shown in Figure 4 below).

[6] Pricing Order clause 12(3).

[7] Pricing Order clause 12(8).

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



## 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 the 2021 Victorian Default Offer price determination.
- We have used the average of forecast wholesale costs for the 12-month period 1 January 2022 to 31 December 2022. This is consistent with the approach we have used in all other Victorian Default Offer reviews.
- Wholesale electricity purchase costs make up around 23 per cent of annual residential bills (averaged across the five distribution zones).
- Our final decision is based on wholesale electricity costs for 2022 being 24 per cent lower than the wholesale electricity costs used in our 2021 decision.

### The futures market has lower wholesale electricity prices for 2022

Energy purchase costs are incurred by retailers when they purchase electricity from the wholesale market to meet the demand of their customers. The pricing order requires us to have regard to the efficient costs of providing retail electricity services, including wholesale electricity purchase costs.[8] We have used a futures market approach to estimate a benchmark energy purchase cost for 2022. The futures market approach is based on an estimate of the costs that a retailer would face in supplying electricity to their customers using financial hedging products purchased on ASX Energy. We used this approach in making our determination on the 2021 Victorian Default Offer. Futures prices are transparent as they are publicly traded. Anyone can access contracts available through ASX energy. In basing our estimate on the futures market, our approach reflects market outcomes and efficient costs. This approach is also consistent with the approach taken by other Australian regulators.[9] Our final decision forecast is 24 per cent lower than the benchmark provided in 2021. We have used the average of forecast wholesale costs for the 12-month period 1 January 2022 to 31 December 2022. This is consistent with the approach we have used in all other Victorian Default Offer decisions.

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

[9] 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.

## Energy purchase costs

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, and while some retailers own generators, many buy electricity directly from generators on the spot market. Buying electricity from the spot market exposes retailers to the risk that electricity 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, the price it pays for electricity is set in advance or capped. Retailers can hedge by either contracting directly with a generator, or through a financial market transaction on ASX Energy, or with another financial intermediary.

## Frontier Economics estimated wholesale electricity purchase costs

We engaged Frontier Economics to estimate wholesale electricity purchase costs. We have considered their approach and accept Frontier Economics' recommendations as reflecting a benchmark of efficient wholesale electricity purchase costs for the purpose of estimating Victorian Default Offer prices. A full description of Frontier Economics' methodology, including data sources, is included in its report.[10] A summary is provided below.

Frontier Economics determined the relationship between load and spot prices using five years of historical data from financial years 2016–17 to 2020–21. Half-hourly customer load data was provided to us by the Australian Energy Market Operator (market operator). Victorian half-hourly spot prices for the same period were sourced from the market operator's publicly available data. Frontier Economics performed a Monte Carlo simulation using historical data on load and price.

The simulation randomly generates a year of half-hourly observations. This process is repeated 500 times to generate a range of simulated years.[11] Each simulated year is normalised in order 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 quarterly ASX Energy base swap price for 2021, subtracting a contract premium.[12]

It then estimated the cost of hedging, as well as the hedging position a prudent retailer would adopt. To estimate the cost of financial hedging, we asked Frontier to use 12-month trade-weighted hedging contract prices on quarterly electricity derivative contracts (base swaps, peak

[10] Frontier, Wholesale electricity costs for 2022: A final report for the Essential Services Commission, October 2021.

[11] 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).

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

swaps, and base $300 caps). An efficient contracting position was then estimated using Frontier Economics' STRIKE model. An amount for holding working capital (cash) to fund spot market purchases was also included – a volatility allowance which funds shortfalls during periods of very high spot prices.

### Our approach to estimating wholesale electricity costs remains the same

Our final decision maintains the approach we used to estimate wholesale costs in in our past Victorian Default Offer determinations, and our final advice to government in 2019.[13]

In response to our proposal to set a 6-month Victorian Default Offer period, some retailers proposed that we should adjust our wholesale electricity cost estimate from a 12-month period to a 6-month period. They considered it would better reflect their underlying costs.

We did not adopt this proposal. In maintaining a 12-month forecast period for wholesale costs, we have considered how best to meet the objectives of the Victorian Default Offer, including that it is intended to provide a simple, trusted and reasonably priced option for customers unwilling or unable to engage in the market.

We consider changing our approach to forecasting wholesale electricity costs for a 'transitional' 6-month regulatory period would not increase trust in the Victorian Default Offer and would not promote the long term interests of consumers.

In coming to this decision, we have also had regard to the financial viability of the sector, and the efficient costs to deliver an electricity retail service. We consider that our final decision to consistently use a 12-month average of estimated wholesale costs will allow retailers to recover their efficient costs over the long term. Using a 12-month estimate should also support greater price stability for customers than using a 6-month period.

We also consider that comprehensive consultation through our previous determination processes has developed an approach that is largely accepted as providing reasonable estimates of the cost of wholesale electricity. Our approach is also broadly consistent with the approach taken by other

[13] Essential Services Commission, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, May 2019; Essential Services Commission, Victorian Default Offer to apply from 1 January 2020: Final decision, November 2019; Essential Services Commission, Victorian Default Offer to apply from 1 January 2021: Final decision, November 2020.

Australian regulators.[14] Regulatory consistency is important for setting prices, particularly for promoting trust in the Victorian Default Offer.

After considering these factors, we are of the view that our final decision best promotes the long term interests of consumers and addresses our legislative requirements.

## We considered stakeholder submissions on wholesale costs

Stakeholders raised a number of matters relating to wholesale costs. The main area of comment was the forecast period for wholesale costs.

### Wholesale cost forecast period

Consumer Action Law Centre supports the use of a 12-month averaging period to forecast wholesale costs for the 2022 Victorian Default Offer. It considers using only a 6-month average wholesale cost for the first half of 2022 (a period for which wholesale costs are generally higher compared to the second half of the year) would be inconsistent with past reviews. It also submits that using a 6-month forecast period ignores the reality of retailer hedging behaviour and carries the risk that prices will be unstable which is not in the long-term interest of Victorian consumers.[15] It also submitted that our approach is conservative, as it only includes hedging through ASX contracts, and should be treated as an upper bound rather than an efficient estimate.

Some retailers submitted that using an annual forecast for wholesale energy costs in the 1 January 2022 Victorian Default Offer would underestimate retailers' costs for this 6-month regulatory period.[16] Wholesale prices tend to be higher in the first half of the calendar year. This means a 6-month average wholesale price for the first half of 2022 would be higher than the average for the whole of 2022.

We accept that wholesale costs are likely to be higher in the first half of the calendar year than the annual average. There may also be some support for using a 6-month forecast period if this determination was made in isolation. However, we are not setting prices for a 6-month regulatory period in isolation. Using a 12-month estimate of wholesale costs allows for the recovery of

[14] 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.

[15] CALC, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 2.

[16] AGL, submission to the Victorian Default Offer from 1 January 2022: Draft decision, pp.2-3; Alinta Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, pp. 2-3; Powershop, submission to the Victorian Default Offer from 1 January 2022: Draft decision, pp.1-2, EnergyAustralia, submission to the Victorian Default Offer from 1 January 2022: Draft decision, pp. 1-3, Simply Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 1.

efficient costs. As noted above, we do not think it is in customers' long term interests to change our approach. We have not received evidence to suggest that retailers' underlying costs have changed at an industry wide level.

To the extent that wholesale costs might turn out to be higher than the estimate included in the Victorian Default Offer cost stack, our approach will continue to represent a reasonable estimate of efficient costs and will not impact financial viability. Overall comparisons of the Victorian Default Offer prices to retailers' actual costs show Victorian Default Offer prices are within the range of retailers' observed total costs. This is supported by the fact that Victorian Default Offer prices lie above retailers' median market offers.

AGL also submitted that while a 12-month forecast period was appropriate for the 6-month regulatory period in 2019, this time it is not. It stated that:

> Retailers had already made their annual price changes in January 2019 and these price changes would have assumed an annual wholesale cost estimate for 2019. The ESC using an annual wholesale cost estimate for 2019 in this instance was therefore appropriate as it estimated what retailers needed to recover for their average wholesale electricity cost, including the higher costs incurred over quarters 1 and 2 of that calendar year.[17]

While it is possible that AGL may have set its prices for standing offer customers on this basis, the data available to us suggests that the industry as a whole did not.[18]

Alinta submitted: [19]

> …the VDO set for 2022-23 will reflect the circumstances of the market at that time and beyond, which is likely to involve the exit of substantial generating capacity (Liddell Power Station). This may result in a significant difference in the estimate of the wholesale cost component for the first six months of 2022 relative to the subsequent financial year VDO.
>
> Estimating wholesale costs by limiting the analysis period to the first six months of 2022 would smooth the transition to estimation of wholesale costs over the 2022-23 financial year.

[17] AGL, submission to the Victorian Default Offer from 1 January 2022: Draft decision, pp. 2-3.

[18] The median standing offer bill in Victoria for residential customers across all retailers prior to the introduction of the Victorian Default Offer was $1,788. This was $380 or 27 per cent higher than the average residential Victorian Default Offer prices for the second half of 2019.

[19] Alinta Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, pp. 1-2.

Base swap contracts on ASX energy suggest that the market expects average wholesale prices to be lower in 2023 than in 2022.[20] This suggests using a 6-month period would increase price variability rather than reduce it.

### Impact of roof-top solar on load profile and spot prices

Origin Energy and Powershop submit the average consumption load profile for residential customers has become more variable in the last two years.[21] Origin Energy and Powershop consider the commission should place more weight on recent data as it is likely to be a more accurate representation.

We agree with Origin Energy and Powershop that there has been an observable change in the average daily load profile or "typical" daily consumption pattern for residential customers over the period. We also agree with Origin Energy's observation that trends in both load and spot prices are likely to be a good guide to future trends.

To understand if only more recent years should be used to forecast future load, it is useful to calculate the load premium for past years(the load-weighted price divided by the time-weighted price). The load premium measures the impact of load volatility on wholesale prices.

Analysis from Frontier on the load premium suggest that the earlier years are more consistent with the load premium for recent years, particularly for business customers. For this reason, and that including a longer time series captures greater diversity of outcomes in the modelling of wholesale costs, we consider keeping our approach is appropriate for this Victorian Default Offer.[22]

### Cut-off date for trade-weighted contract prices

Powershop prefers the cut-off date of the trade-weighted contract price data to be after the option expiry date in the ASX.[23]

Frontier uses a 12-month trade weighted average of ASX Energy contract prices to forecast wholesale prices. This means high-volume trading days are accounted for. The relevant date for option expiry for the calculation of the Victorian Default Offer for 2022 is 19 November 2021. As outlined in Frontier's report, we cannot include the trade weighted data up to and including 19

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[20] ASX Energy, AU Electricity – Victoria, available at: https://www.asxenergy.com.au/futures_au/V (last accessed 22 November 2021).

[21] Powershop, submission to the Victorian Default Offer from 1 January 2022: Draft decision, pp. 1-2; Origin Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 6.

[22] Frontier, Wholesale electricity costs for 2022: A final report for the Essential Services Commission, October 2021, pp. 11-20.

[23] Powershop, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 2.

November 2021, given our statutory deadlines.[24] As in the previous decisions, we consider that the most recent contract data is the best indicator of future prices.

### We factored network losses into our final decision

When electricity is transported through transmission and distribution networks, some of it is lost in the process. Electrical losses occur because of electrical resistance in the wires, converting some electricity to heat. These losses must be factored into any electricity purchased through the wholesale market to ensure supply meets demand. As a result, more electricity is generated than is consumed by end users.

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

Our final decision for distribution loss factors is 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 zones.[25]

For marginal loss factors, we take a simple average of the relevant regional reference node factors for each distribution zone.[26] We removed some transmission nodes as they do not have any residential or small business load.

We combine these to calculate an adjustment factor which is applied to wholesale costs, environmental costs, and other costs that include National Electricity Market fees, ancillary charges, and compliance costs.

### We considered submissions on load factors

Our draft decision used the average of the short and long sub-transmission distribution loss factors as it is more transparent and easily replicable. Our analysis found both approaches produced similar results with less than half a per cent difference in customers' annual bills. The weighted average results in a small increase to the benchmark for the Powercor distribution zone and a small decrease in Ausnet distribution zone. EnergyAustralia asked that we reconsider our draft

[24] Frontier, Wholesale electricity costs for 2022: A final report for the Essential Services Commission, October 2021, pp. 29-30.

[25] Australian Energy Market Operator, Distribution Loss Factors for the 2021-22 Financial Year, July 2021, p. 13; Citipower, Powercor & United Energy, response to Distribution data: solar export and transmission lines, July 2021; AusNet, response to request on AusNet data - solar export and transmission lines, July 2021.

[26] Australian Energy Market Operator, Marginal Loss Factors for the 2021-22 Financial Year, July 2021, pp. 24-29.

decision position on the basis that a weighted average would be more accurate.[27] After considering the matter further, although across all of Victoria the change may be immaterial, we accept that within the distribution zones it may not be. As a result we have decided to use a weighted average for the Ausnet and Powercor distribution zones for our final decision.

EnergyAustralia also noted that some transmission node identifiers do not serve any small business or residential load. We investigated this matter with the Australian Energy Market Operator and as a result removed a small number of nodes when calculating the marginal loss factor.[28]

## Network costs

- Our final decision continues to use a cost pass through approach for estimating network costs.
- Our final decision uses the network tariffs approved by the Australian Energy Regulator for the 2021–22 financial year.
- Network costs represent about 39 per cent of the average residential bill (averaged across the five distribution zones).

Network costs represent the costs of building, operating and expanding the electricity distribution and transmission networks. We are required to have regard to network costs in estimating efficient costs.[29]

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 on an annual basis.

[27] EnergyAustralia, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 5.

[28] Australian Energy Market Operator, email to the commission: Query about Marginal Loss Factors: locations and users, 20 September 2021.

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

### Our final decision is to keep our approach to network tariffs

We have kept our past approach for calculating network costs. This is a cost pass through approach using the network tariffs approved by the Australian Energy Regulator for each distribution zone (see appendix A). This approach has broad support from stakeholders.[30]

## Under or over recovered network costs for July and August 2021

- Our final decision includes an adjustment for under or over recovered network costs from July and August 2021 in the first half of 2022.
- The amount to be recovered is based on actual usage for the months of July and August 2021.
- Any under or over recovery of network costs will be added to the daily supply charge for all standing offer customers (except for controlled load usage).

Network costs are treated as a pass through in the Victorian Default Offer methodology. They are costs incurred by retailers in providing retail services with the network tariffs approved by the Australian Energy Regulator.

We amended the 2021 Victorian Default Offer price determination to account for the new Australian Energy Regulator approved network tariffs applying from 1 July 2021. Our final decision on the variation took effect on 1 September 2021. The effective date for the variation of 1 September means that the benchmark we use for retailers' costs did not match with Victorian Default Offer prices for the months of July and August 2021. There was a difference between the network costs included in Victorian Default Offer prices and actual network costs for the period between 1 July and 31 August 2021.

Our final decision on the variation was to include any under or over recovered network costs in the 1 January 2022 Victorian Default Offer.[31] In making that decision, we took into account customer

[30] Alinta Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 16 June 2021, p. 2; Origin Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 16 June 2021, p. 3; Momentum Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 16 June 2021, pp.3-4; Simply Energy, Submission to the commission's Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, 15 June 2021, p.3.

[31] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, pp. 15–18.

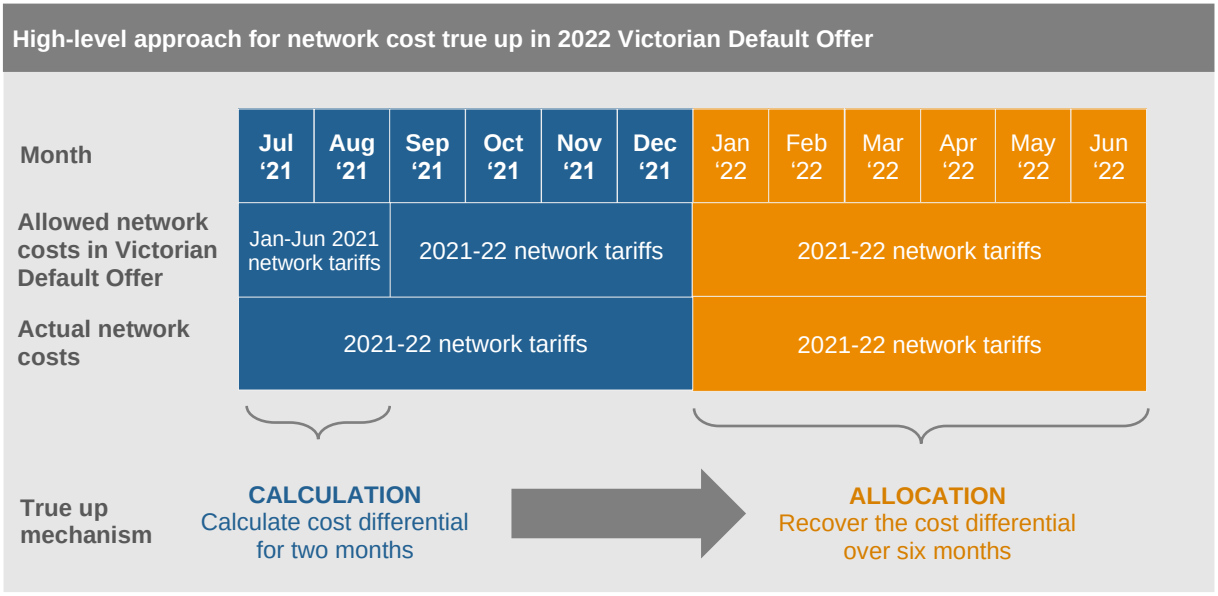
impacts, any operational disruptions our decision might create and different stakeholder views on how to account for the network cost differentials.[32]

Consistent with our final decision for the variation, our final decision for this Victorian Default Offer is to let retailers recover under or over recovered network costs from July and August 2021. These costs are not immaterial, and retailers should be able to recover them as soon as it is practical to do so (that is, from 1 January to 30 June 2022).

### Any under or over recovery will be based on actual usage

We estimated the amount of under or over recovered costs for July and August 2021 based on actual electricity usage for those two months. This means that any adjustment for under or over recovered network costs are more cost reflective. Figure 5 shows how we have calculated the difference in network costs for July and August 2021 and allocated this difference to Victorian Default Offer prices for the first half of 2022. See appendix B for more details about calculation and allocation.

**Figure 5: High-level approach for network cost true up from 1 January 2022**




For our final decision, we have used the Australian Energy Market Operator's usage data for July and August 2021.[33]

[32] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, pp. 15–16.

[33] For our draft decision, we used the Australian Energy Market Operator's usage data for July and August 2020 given the 2021 data was not yet available at that time.

Tables 2 and 3 show the estimated cost impact for each distribution zone and customer type.

**Table 2: Flat tariff customers – estimated under or over recovered network costs: July–August 2021, on average per distribution zone, $ per customer incl GST**

| Distribution zone | Domestic customers | Small business customers |
|---|---|---|
| AusNet Services | $11.94 | $25.62 |
| Citipower | $16.19 | $9.23 |
| Jemena | $14.09 | $26.52 |
| Powercor | $14.09 | $11.83 |
| United Energy | $6.36 | -$0.73 |
| Victoria (average) | $12.53 | $14.49 |

Notes: Based on the difference between the network charges in the original and amended 2021 determinations. Under recovery is in positive dollars. Over recovery is in negative dollars. See appendix B for details.

**Table 3: Two-period time of use tariffs – estimated under or over recovered network costs: July–August 2021, on average per distribution zone, $ per customer incl GST**

| Distribution zone | Domestic customers | Small business customers |
|---|---|---|
| AusNet Services | -$6.40 | -$59.60 |
| Citipower | $14.83 | $3.65 |
| Jemena | -$3.71 | $10.34 |
| Powercor | $11.22 | $5.72 |
| United Energy | $4.89 | -$6.20 |
| Victoria (average) | $4.16 | -$9.22 |

Notes: Based on the difference between the network charges in the original and amended 2021 determinations. Under recovery is in positive dollars. Over recovery is in negative dollars. See appendix B for details.

### Recovery will be through the daily supply charge

The amount to be recovered by retailers will be added only to the daily supply charge, except for controlled load usage charges. This will be more accurate than relying on assumptions about what customer usage will be for the first half of 2022. Electricity usage may vary for customers over the six months from the representative domestic and small business consumption, leading to either more or less network costs recovered from customers.

This approach assumes that customer numbers will stay roughly unchanged. We have observed that over the last twelve months total customer numbers have remained reasonably stable.

For under or over recovered network costs on controlled load usage, the amount will be recovered through the controlled load usage rate. Only some standing offer customers incur these costs, so they cannot be added into the daily charge applied to all standing offer customers.

### We considered stakeholder submissions on under or over recovered network costs

Retailers support our approach to under or over recovered network costs for July and August 2021.[34] Origin Energy supports our approach but notes that the adjustment appears to exclude retail operating margin.[35] Our estimate of under or over recovered costs accounts for the retail operating margin as shown in the Victorian Default Offer model we have published together with this final decision paper.[36]

Powershop also generally supported our approach. However it noted that for customers with controlled load, our approach of assuming uniform usage across the 12 months may underestimate costs.[37] Powershop suggested that we true-up the variable cost using a weighted monthly usage using the net system load profile as a proxy in absence of a controlled load profile to better estimate the true up for controlled load customers.[38]

We investigated the suggested approach and compared controlled and net system load profiles in other states. Our analysis showed controlled load usage was likely to be higher in July and August. It also shows that monthly usage as a proportion of annual usage in both the net system and

[34] AGL, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022: Draft decision, October 2021, p. 1; Momentum Energy, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022: Draft decision, October 2021, pp.1-2; Simply Energy, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022: Draft decision, October 2021, p. 3; Origin Energy, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022: Draft decision, October 2021, p.7; Powershop, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022: Draft decision, October 2021, pp.2-3; Alinta Energy, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022: Draft decision, October 2021, p.1.

[35] Origin Energy, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022: Draft decision, October 2021, p.7.

[36] Essential Services Commission, Victorian Default Offer from 1 January 2022: Final decision model, November 2021, Sheet named Calc_TU_values, (https://www.esc.vic.gov.au/electricity-and-gas/prices-tariffs-and-benchmarks/victorian-default-offer/victorian-default-offer-price-review-2022#tabs-container2).

[37] Powershop, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022: Draft decision, October 2021, pp.2-3.

[38] ACIL Allen (2021), Report to Australian Energy Regulator, Default Market Offer 2021–22, Wholesale energy and environment cost estimates for DMO 3 Final Determination, pp.32–33, accessed 15 October 2021, https://www.aer.gov.au/system/files/ACIL%20Allen%20-%20DMO%202021-22%20Final%20Determination%20-%20Wholesale%20and%20environmental%20costs%20-%2019%20April%202021.pdf.

controlled load profiles are similar [39] This supports Powershop's suggestion that Victoria's system load profile can be used as a proxy for the controlled load profile in estimating the usage for under or over recovered network costs for controlled load customers.

In our final decision, we have based the under or over recovered network costs for controlled load tariffs on weighted monthly usage. We used Victoria's load profile taken from manually read interval meter data for weighting.[40] This approach better reflects controlled load customers' electricity demand for the months of July and August. For our final decision, the average network cost recovery for controlled load for July and August 2021 is an under recovery of $2.4 (from $1.7 in the draft decision).[41] As indicated earlier the full amount of that under recovery has been treated as a pass through in this Victorian Default Offer. See Table B.11 for the under or over recovered network costs for each distribution zone.

## Environmental costs

- Our final decision is to continue to use generally the same approach to estimating environmental costs that we used in our final decision on the 2021 Victorian Default Offer.
- Environmental costs represent about 10 per cent of the average residential bill (averaged across the five distribution zones).
- Our final decision means the dollar value of environmental costs in the cost stack will increase by 27 percent compared to the amount in the 2021 Victorian Default Offer. This is mainly driven by increases in Victorian energy efficiency certificate prices used to estimate Victorian Energy Upgrades costs.

Under the pricing order, we are required to have regard to environmental costs.[42] There are four main environmental costs faced by Victorian electricity retailers:

[39] Australian Energy Market Operator, Load Profiles, accessed on 26 October 2021, https://aemo.com.au/energy-systems/electricity/national-electricity-market-nem/data-nem/metering-data/load-profiles.

[40] Network System Load Profile provides data for all accumulation meters only. We have used this data to compare it with Controlled Load Profile for New South Wales and South Australia. For Victoria, we have considered load profiles from Manually Read Interval Meter data. See: Australian Energy Market Operator, Victorian MRIM meter data, accessed 26 October 2021, https://aemo.com.au/energy-systems/electricity/national-electricity-market-nem/data-nem/metering-data/victorian-mrim-meter-data.

[41] See Essential Services Commission, Victorian Default Offer from 1 January 2022: Final decision model, November 2021, Sheet named Calc_TU_values, (https://www.esc.vic.gov.au/electricity-and-gas/prices-tariffs-and-benchmarks/victorian-default-offer/victorian-default-offer-price-review-2022#tabs-container2).

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

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

Our final decision for environmental costs is higher than the benchmark included in the 2021 Victorian Default Offer. In the average annual bill for residential and small business customers, the benchmark for environmental costs has increased by around 27 per cent. This is largely because of changes to the Victorian energy efficiency certificate prices used to calculate Victorian Energy Upgrades costs.

### Our final decision is to keep our general 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 small-scale technology percentage will be multiplied by the clearing house price
- Large-scale Renewable Energy Target – the 2022 default renewable power percentage will be multiplied by the futures market price for large-scale certificates
- Victorian Energy Upgrades – the 2021 greenhouse reduction rate for electricity will be multiplied by the historic 12–month trade-weighted average price for Victorian Energy Efficiency Certificates
- Minimum feed-in tariff (social costs of carbon) – total renewable exports in 2020–21 will be divided by average total domestic and small business customers in 2020–21, multiplied by the social cost of carbon (2.5 cents).

The above costs, aside from the social cost of carbon, are multiplied by network loss factors.

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

The Small-scale Renewable Energy Scheme places an obligation on retailers to purchase small-scale technology certificates. The Clean Energy Regulator publishes the small-scale technology percentage every year which sets the amount of small-scale technology certificates retailers must buy.

Our final decision is to use the same approach to calculating the cost of the Small-scale Renewable Energy Scheme as in previous Victorian Default Offer decisions. We use the 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 have 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.

The Small-scale Renewable Energy Scheme cost for 2022 is lower than the cost for 2021. While the binding small-scale technology percentage in 2021 is higher than in 2020 due to strong growth in rooftop solar uptake,[43] the Clean Energy Regulator has set a lower non-binding small-scale percentage for 2022 than for 2021.[44]

The 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 is slightly higher but this has only minimal impact on the overall small-scale renewable energy scheme costs for 2022.[45]

AGL supports our decision to include the adjustment to account for the discrepancy in the binding and non-binding small-scale technology percentages in recent years.[46]

Origin states that we should calculate the true-up based on the difference between the non-binding small-scale technology percentage and the actual binding small-scale technology percentage in 2021.[47] Our calculation of the true-up is based on the difference between the percentage used in the previous decision (the mid-point of the 2021 non-binding and the 2020 binding percentages), and the binding 2021 percentage (which reflects retailers' actual costs for 2021). This approach more accurately reflects the difference between costs in the 2021 Victorian Default Offer and retailers' actual costs for 2021. For more details, please refer to the Victorian Default Offer final decision model.[48]

### We have 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 financial incentive for the installation of renewable energy power stations.

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[43] Clean Energy Regulator, Quarterly Carbon Market Report – March Quarter 2021, p. 33.

[44] Available at http://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-small-scale-technology-percentage.

[45] 6.90 per cent in this decision compared to 6.25 per cent in the 2021 Victorian Default Offer decision.

[46] AGL, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, October 2021, p.3.

[47] Origin, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, October 2021, p. 7.

[48] Essential Services Commission, Victorian Default Offer from 1 January 2022: Final decision model, November 2021, Sheet named Calc_TU_values, (https://www.esc.vic.gov.au/electricity-and-gas/prices-tariffs-and-benchmarks/victorian-default-offer/victorian-default-offer-price-review-2022#tabs-container2).

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 large scale generation certificates to meet their legally binding renewable energy obligations. Electricity retailers then surrender these certificates to the Clean Energy Regulator based on the renewable power percentage the regulator sets each year.

Our final decision is to keep our approach to calculating the cost of complying with the Large-Scale Renewable Energy Target. Our approach uses the 2022 default renewable power percentage multiplied by the futures market price for large-scale certificates to estimate the costs retailers incur to comply. In total, using our approach, the benchmark for these costs has gone down slightly.

We have included a true-up mechanism to account for the difference between the default renewable power percentage we used in the 2021 decision and the actual binding renewable power percentage for 2021[49]. As the liability percentage in the previous decision was higher than the actual percentage, the true-up is negative. The resulting estimate can be seen in table B.12.

We did not receive any further submission on our approach to estimating the costs of compliance with the Large-scale Renewable Energy Target in the draft decision.

### We have kept our approach to calculating Victorian Energy Upgrades 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 (certificates). Energy retailers must acquire and surrender these certificates to meet annual targets set in Victorian legislation.

Our final decision is to keep our current approach to calculating these costs. Our approach uses the 2021 greenhouse gas reduction rate for electricity, multiplied by the historic 12-month trade-weighted average price for certificates.

As signalled in our draft decision, we used updated data to calculate the trade-weighted average price for Victorian energy efficiency certificates in making this final decision. Using these updated inputs leads to a certificate price of $56.94. This is $24.56 higher than the estimate used to

[49] The renewable power percentage used in the 2021 decision was 18.83 per cent while the actual binding renewable power percentage for 2021 was 18.54 per cent

calculate Victorian Energy Upgrades costs for the 2021 Victorian Default Offer and $7.30 higher than the estimate used in our draft decision.

We used the 2021 greenhouse gas reduction rate for electricity as the reduction rate for 2022 is not currently available.

### We considered stakeholder submissions on Victorian Energy Upgrades costs

We received submissions on Victorian Energy Upgrades costs from retailers and consumer advocates.

Retailers submitted that the recent increase in Victorian energy efficiency certificate prices would not be fully accounted for under a trade weighted 12-month average approach.[50] Retailers submitted that there were a number of reasons for this. These included:

- residential lighting efficiency activities being removed from the program
- a drop in the program's electricity emissions factor and
- coronavirus restrictions stopping accredited installers from creating certificates.

They submitted that these issues in the program are beyond their control and expose them to the risk of the commission issuing shortfall penalties if they do not surrender their certificate liabilities by the required date. They also stated these issues were likely to continue into the future.

Several retailers proposed alternative approaches to us which would allow them to recover their costs. These included:

- an explicit adjustment for penalty payments with a subsequent true-up to reflect actual payments
- an upwards adjustment to reflect the higher market price of certificates
- accounting for any substantial changes through a true-up mechanism
- excluding pre-2021 certificate prices to ensure more current values are used
- adding a risk premium to the current approach.

[50] Origin, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, October 2021, p. 4-6; EnergyAustralia, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, October 2021, p. 4-5; Red & Lumo, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, October 2021, p. 2-3; AGL, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, October 2021, p. 6; Alinta, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, October 2021, p. 2; MEA Powershop, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – draft Decision, October 2021, p. 2; Momentum, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, October 2021, p. 4-5.

On the other hand, consumer groups support maintaining our current approach.[51] They submitted that retailers are better placed to manage the price risks of the program. Consumer Action Law Centre stated in their submission

> Retailers could be innovating and more actively engaging in this scheme to reduce the prices of certificates and therefore costs to comply with the scheme.[52]

We consider keeping our current approach is appropriate. As at 7 November, 100 per cent of the 2021 certificate target and approximately 45 per cent of the 2022 target has already been met.

Further, on 25 October 2021, we provided an extension from 30 April 2022 to 31 July 2022 for retailers to surrender their 2021 certificate liability.[53] Alongside this, we streamlined our certificate validation process to reduce the time to register certificates.[54] On 27 October 2021, the Department of Environment, Land, Water and Planning announced that residential lighting efficiency activities will be permitted for a further year up until to 31 January 2023.[55] Alongside this, the Department is consulting with stakeholders on further actions to address the impact of coronavirus restrictions and high certificate prices.[56]

However, we will monitor the impacts of these changes on the price of certificates and hence our approach to incorporating these costs into the Victorian Default Offer cost stack.

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[51] VCOSS, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, September 2021, p.1; CALC, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, September 2021, p.3.

[52] CALC, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, September 2021, p.3.

[53] Essential Services Commission, Letter to VEU energy retailers and accredited persons, 25 October 21, accessed 3 November 2021, Extension for relevant entities to surrender their 2021 compliance year certificate liability | Essential Services Commission.

[54] Essential Services Commission, Letter to VEU energy retailers and accredited persons, 25 October 21, accessed 3 November 2021, Extension for relevant entities to surrender their 2021 compliance year certificate liability | Essential Services Commission.

[55] Department of Environment, Land, Water and Planning, Victorian Energy Upgrades VEU Market Consultation Paper, October 2021, accessed 3 November 2021, https://www.energy.vic.gov.au/__data/assets/word_doc/0033/546990/VEU-market-consultation-paper-Oct-2021.docx.

[56] Department of Environment, Land, Water and Planning, Victorian Energy Upgrades VEU Market Consultation Paper, October 2021, accessed 3 November 2021, https://www.energy.vic.gov.au/__data/assets/word_doc/0033/546990/VEU-market-consultation-paper-Oct-2021.docx.

We also received a submission from a Victorian consumer.[57] The submission stated that Victorian Energy Upgrade program costs should not be included in determining the Victorian Default Offer. However, under the pricing order we must consider environmental costs.[58]

### We have 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. This feed-in tariff includes the social cost of carbon. The social cost of carbon is the value of lowering carbon emissions when energy is sourced from small-scale renewable generators. The Victorian Government set the social cost of carbon at 2.5 cents per kWh.[59] 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 is to maintain our current approach to calculating the cost associated with the minimum feed-in tariff. To estimate the cost to retailers, we used the 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 (2.5 cents). Growing solar exports mean our estimate of the cost of the minimum feed-in tariff is slightly higher than in the 2021 Victorian Default Offer.

This approach is transparent and easily replicable. It also allows retailers to recover the efficient costs of paying for solar exports.

## Retail operating costs

- Our approach is to continue to use a benchmarking approach to set retail operating costs. This is consistent with the approach used for the 2021 Victorian Default Offer.
- Retail operating costs represent about 11 per cent of costs in the average residential bill (averaged across the five distribution zones).
- The retail operating costs in our final decision are lower than the amount included in our 2021 determination.

[57] Mike Russell, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, September 2021, p.1.

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

[59] 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.

- We have removed the temporary bad debt adjustment for 2022.

Retail operating costs reflect a range of costs incurred by an electricity retailer in conducting its business. These include: 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.[60]

### Our final decision is to use a benchmarking approach to retail operating costs

The 2022 benchmark for retail operating costs per customer is based on an amount of $121.07 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 (CPI) since 2017 which leads to an annual benchmark of $130.91.

In addition to this benchmark, we have set an annual amount for additional regulatory costs and Victoria specific operating costs of $10. This amount 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.[61] Our final decision also continues to include a small annual amount of $0.84 for the ongoing operating expenditure associated with five-minute settlement. Our final decision removes the temporary adjustment provided in 2021 to account for the effect of the pandemic on bad debts.

Our final decision annual benchmark of $141.75 per customer is lower than the current (2021 Victorian Default Offer) benchmark of $143.30. This is due to the removal of the temporary adjustment for bad debts which is partly offset by inflation.

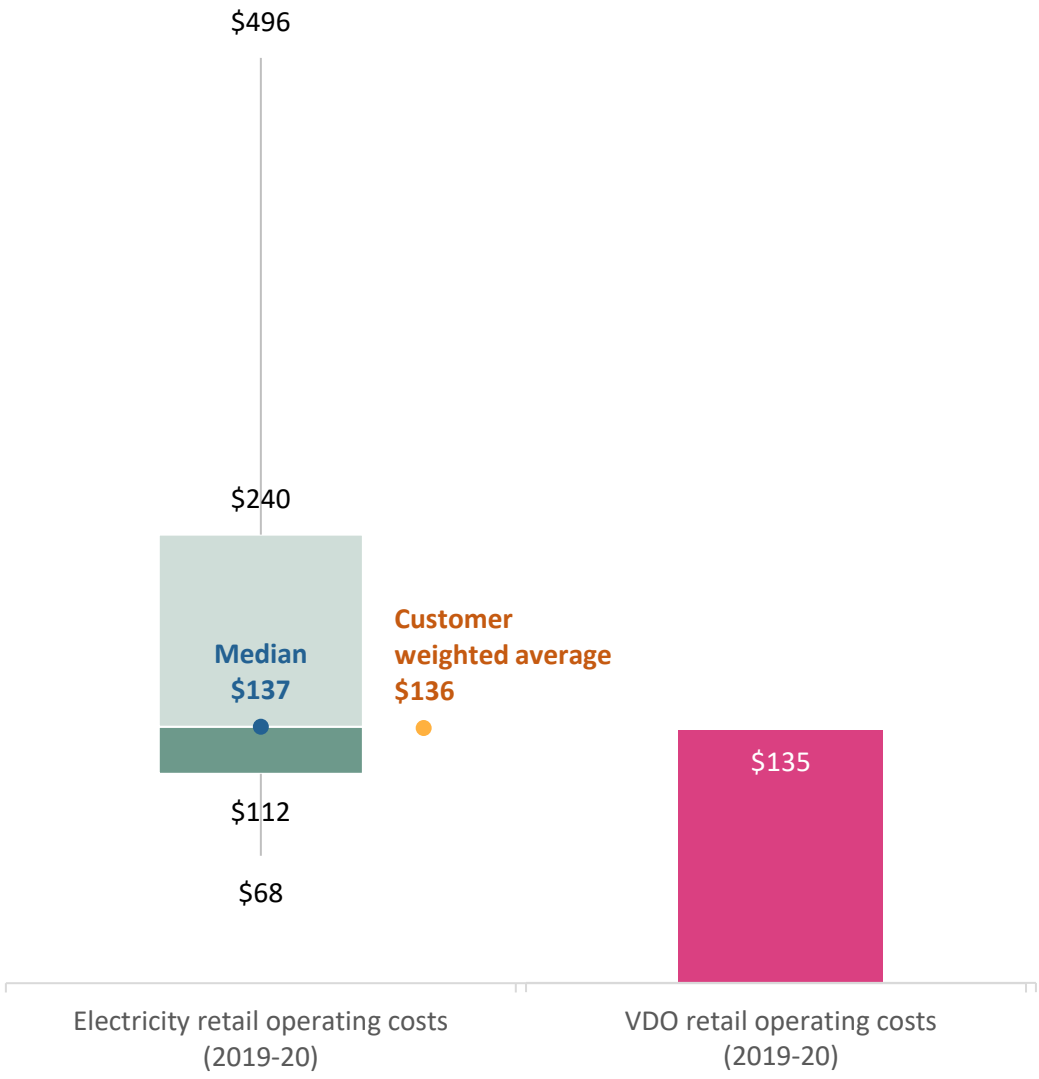
### The benchmark approach is transparent and based on efficient costs

Our approach to calculating a benchmark for retail operating costs represents a transparent and simple approach. It is replicable and based on public information. This is consistent with the methodology we used in the Victorian Default Offer for 2021 and has been adopted for regulated prices in Queensland and Tasmania.

[60] 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.

[61] 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.

**Figure 6: Comparison of retailers' reported total costs to serve and our benchmark**




Source: Energy retailers, data obtained via a notice issued to electricity retailers in 2021. Costs are GST exclusive.

The level of our benchmark is appropriate because it has been updated for inflation and we have cross checked it with actual data provided by Victorian retailers. We examined combined cost to serve and bad debt costs reported by retailers and found a customer weighted average of $136. We also found there was a wide range of costs reported. Retailers' costs varied with differences in business model and structure, scope of operations and bad debts. Figure 6 above shows the benchmark we have set falls within the range of costs reported by retailers.

## The temporary bad debt adjustment is not required in 2022

Bad debts occur when customers cannot pay their electricity bills. Retailers may be able to recover some of these costs from customers, but some customers may never pay their debts. In determining the efficient retail operating costs for 2021 we included a temporary upward

adjustment of $6 per customer to account for the effect of the coronavirus pandemic on bad debts. This upwards adjustment was in addition to the baseline cost of bad debts already included in our retail operating cost benchmark. We asked for forecasts of retailers' bad debts for 2022, and evidence supporting those forecasts in order to understand whether an adjustment for bad debt would be required in 2022.

Our final decision removes the temporary upwards adjustment we made for bad debts. The data available to us suggests the adjustment is no longer needed.

### Recent lockdowns have interrupted recovery but the outlook for 2022 is positive

While restrictions on movement in New South Wales and Victoria due to recent coronavirus outbreaks have interrupted economic activity, as restrictions ease it is expected economic activity will recover next year. This view is based on:

- Measures of economic conditions – including Australian Bureau of Statistics data[62] on unemployment and the Reserve Bank of Australia's statements on monetary policy [63]
- Government roadmaps on the easing of restrictions - Victoria's roadmap[64] and the national plan[65]
- Publicly available information – AGL's annual report 2021[66], Origin Energy's annual report 2021[67] and Snowy Hydro's (Red/Lumo) annual report 2021[68]
- Information collected from Victorian retailers on average arrears for residential and small business customers during the pandemic.[69]

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[62] Australian Bureau of Statistics, labour force Australia data, September 2021 https://www.abs.gov.au/statistics/labour/employment-and-unemployment/labour-force-australia/latest-release#states-and-territories; Australian Bureau of Statistics, Australian National Accounts: National Income, Expenditure and Product data, June 2021.

[63] RBA, Statement by Philip Lowe, Governor: Monetary Policy Decision, November 2021, p.1.

[64] State Government of Victoria, Victoria's Roadmap: Delivering the National Plan, September 2021, https://www.coronavirus.vic.gov.au/victorias-roadmap.

[65] Australian Government, National Plan to transition Australia's National COVID-19 Response, July 2021, https://www.pm.gov.au/sites/default/files/media/national-plan-to-transition-australias-national-covid-19-response-30-july-2021.pdf.

[66] AGL, 2021 Annual Report, August 2021, https://www.agl.com.au/about-agl/investors/annual-reports.

[67] Origin Energy, 2021 Full Year Report (including appendix 4E), August 2021, https://www.originenergy.com.au/content/dam/origin/about/investors-media/presentations/fy21_origin_energy_full_year_report.pdf.

[68] Snowy Hydro, Snowy Hydro Limited Annual Report for the year ended 2021, https://www.snowyhydro.com.au/wp-content/uploads/2021/10/Snowy-Hydro-Limited-Annual-Report-for-the-Year-Ended-30-June-2021-1.pdf.

[69] The commission has received voluntary data from Victorian electricity and gas retailers for the purpose of monitoring the number of energy customers receiving assistance during the coronavirus pandemic – it is available on our website.

Current measures of economic conditions suggest that while recent lockdowns have led to reduced activity, with restrictions lifting economic activity is expected to increase. This view is supported by recent statements from the Reserve Bank of Australia (reserve bank) and the speed at which gross domestic product and employment recovered following the end of lockdowns in 2020.[70]

Government roadmaps on the easing of restrictions suggest as vaccination coverage increases, restrictions will be eased. With 90 per cent of eligible Victorians vaccinated most restrictions have now been removed. The government roadmaps also tell us we should not expect as many lockdowns next year and any lockdowns are expected to be highly targeted only. [71]

Our analysis of retailers' financial reports and data below suggest while the recent lockdowns may affect bad and doubtful debts incurred in 2021 it is not clear that there will be an effect on bad and doubtful debts in 2022.[72] As mentioned above economic activity is expected to improve next year, and with this the amount of bad and doubtful debts that need to be written off should be lower.

We have also looked at arrears data which tell us how lockdowns have affected customer debt. While the level of arrears per customer are currently higher than pre-pandemic levels, it appears to have stayed relatively stable since February this year. We note this increase in the average level of arrears in 2021 has already been accounted for in the temporary adjustment we made to the 2021 Victorian Default Offer.

### *Economic conditions*

Figure 7 below shows quarterly growth in Gross Domestic Product for Australia.[73] This shows that the initial outbreak of coronavirus and the associated lockdowns affected economic activity. It also

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To understand the relationship and possible impact on bad debts that trends in customer bill arrears we have looked at average arrears (and the monthly change) for customers receiving payment assistance, that are unable to pay on-going usage.

[70] RBA, Statement by Philip Lowe, Governor: Monetary Policy Decision, November 2021, p.1.

[71] Australian Government, National Plan to transition Australia's National COVID-19 Response, https://www.pm.gov.au/sites/default/files/media/national-plan-060821_0.pdf; State Government of Victoria, Victoria's Roadmap - Delivering the National plan, September 2021, https://www.coronavirus.vic.gov.au/victorias-roadmap.

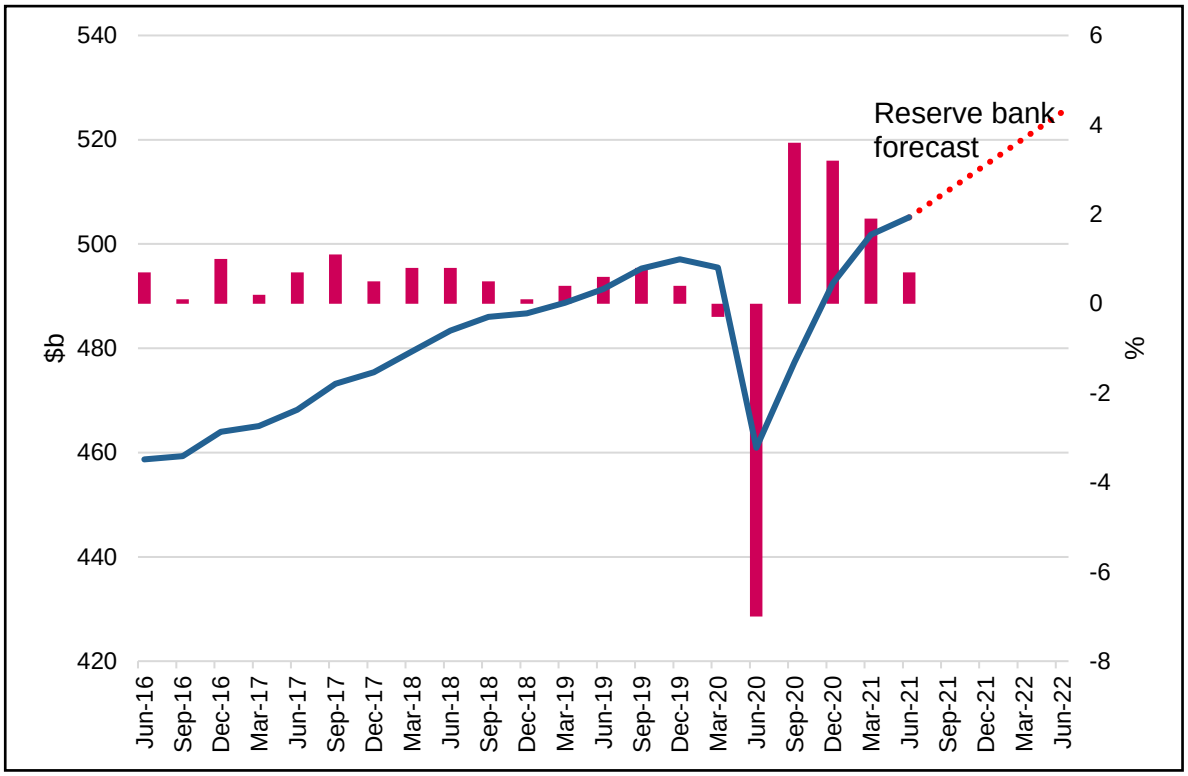
[72] AGL, 2021 Annual Report, August 2021, https://www.agl.com.au/about-agl/investors/annual-reports; Origin Energy, 2021 Full Year Report (including appendix 4E), August 2021, pp. 17, 37, https://www.originenergy.com.au/content/dam/origin/about/investors-media/presentations/fy21_origin_energy_full_year_report.pdf, pp. 24-25; Snowy Hydro, Snowy Hydro Limited Annual Report for the year ended 2021, https://www.snowyhydro.com.au/wp-content/uploads/2021/10/Snowy-Hydro-Limited-Annual-Report-for-the-Year-Ended-30-June-2021-1.pdf, pp. 4, 57-58.

[73] Australian Bureau of Statistics, Australian National Accounts: National Income, Expenditure and Product data, June 2021, https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-national-income-expenditure-and-product/latest-release; RBA, Statement by Philip Lowe, Governor: Monetary Policy Decision, November 2021, p.1.

shows that economic recovery quickly followed the end of lockdowns and is expected to recover quickly again after the most recent round of restrictions.

As vaccination rates increase even further and restrictions are eased, the economy is expected to bounce back relatively quickly. The Reserve Bank of Australia forecast is for gross domestic product to grow by three per cent over 2021, 5.5 per cent in 2022 and 2.5 per cent in 2023.[74]

**Figure 7: Gross domestic product, seasonally adjusted, quarterly growth and level**




Source: Australian Bureau of Statistics and Reserve Bank of Australia

This story is repeated in unemployment figures. Since the beginning of the pandemic, hours worked have been impacted by a series of lockdowns and other restrictions.[75] While hours worked have decreased following lockdowns, they have recovered quickly after their removal.

### *Retailers' reporting on bad debts*

Retailers' annual reports forecast an improvement in the level of bad debts for 2022. While Origin Energy, AGL and Red/Lumo are only three of many retailers that serve Victorian customers, they

[74] RBA, Statement by Philip Lowe, Governor: Monetary Policy Decision, November 2021, p.1.

[75] Australian Bureau of Statistics, Insight into hours worked, August 2021, https://www.abs.gov.au/articles/insights-hours-worked-august-2021

account for over roughly 50 per cent of customers. Origin and AGL are also likely to account for a large share of Victorian Default Offer customers.[76] Given this large share of customers, their public results on bad debts may provide insight into the broader trend for the industry.

Retailers reported actual bad debt expenses are lower than forecast at the beginning of the year.[77] We also note that, once changes in customer numbers are accounted for, the current levels of reported bad debt expenses are at similar levels as in 2019, before the pandemic began.

Figure 8 below divides retailers' reported bad debt expenses by their customer numbers. The change in debt levels from pre-pandemic years to 2021 can give us an indication about what may happen to customer debt in 2022. Origin Energy's bad debt per customer decreased between 2020 and 2021 and is similar to pre-pandemic levels. AGL's bad debt per customer has decreased slightly since the pandemic began. Red/Lumo's per customer bad debt has increased from pre-pandemic levels with a small decrease in 2021 from 2020 levels.

Red/Lumo also significantly increased its provision for doubtful debts in 2021.[78] However, we note that despite the large increase in provisions for financial year 2021, the expense for doubtful debts recognised on trade receivables in 2021 is only slightly more than in 2020.[79]

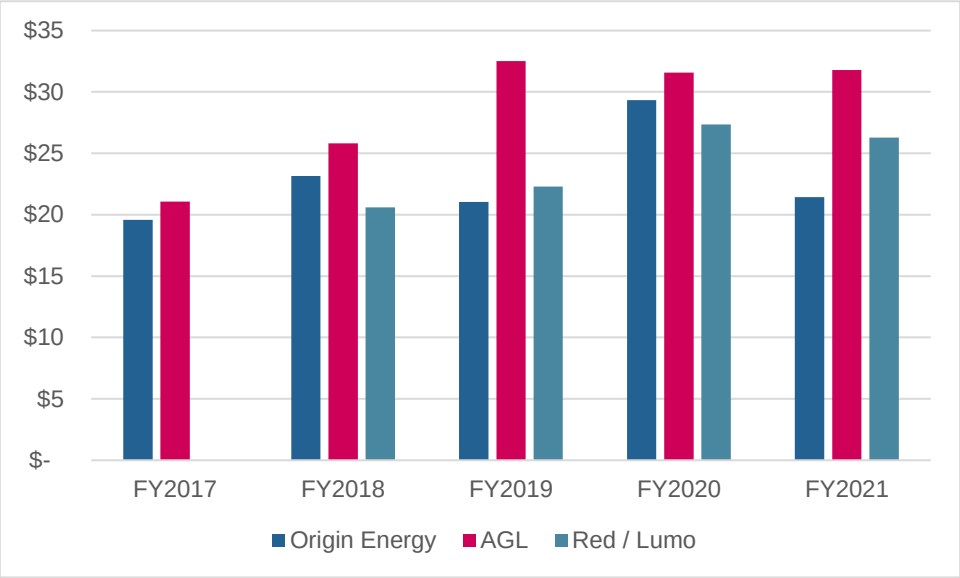
[76] The majority of standing offer customers are customers with AGL, EnergyAustralia and Origin Energy.

[77] Origin Energy, 2021 Full Year Report: Where all good change starts, August 2021, pp. 24-25; Origin Energy, Annual Report: Financial Year 2020, pp. 31-32; Origin Energy, Annual Report: Financial Year 2019, pp. 35, 112; Origin Energy, Annual Report: Financial Year 2018, pp. 54, 117; AGL, Annual Report: Financial Year 2021, pp. 17, 37; AGL, Annual Report: Financial Year 2020, pp. 43, 108; AGL, Annual Report: Financial Year 2019, pp. 12, 47; AGL, Annual Report: Financial Year 2018, pp. 9, 87; Snowy Hydro, Snowy Hydro Limited Annual Report for the year ended 2021, pp. 4, 57-58; Snowy Hydro, Snowy Hydro Limited Annual Report for the year ended 2020, p. 7, 46; Snowy Hydro, Snowy Hydro Limited Annual Report for the year ended 2019, pp. 5, 43.

[78] Snowy Hydro, Snowy Hydro Limited Annual Report for the year ended 2021, p. 58.

[79] Snowy Hydro, Snowy Hydro Limited Annual Report for the year ended 2021, p. 54.

**Figure 8: National bad and doubtful debt per customer**




Source: Energy Retailers, Annual Reports

Our draft decision noted we were interested in forecasts of retailers' bad debts for 2022, and evidence supporting those forecasts.[80] Some retailers provided confidential information on 90 plus day debt, bad debt as a proportion of revenue, and disconnection and debt waiver information. The information provided suggests the downturn in economic activity that comes with lockdowns may increase customer debt levels.[81]

One retailer provided confidential forecasts with an expected increase in the level of bad debts per customer in 2022.[82] The basis of the forecasts was not provided. That retailer also provided its changes in bad and doubtful debt provisions for the effect of the pandemic. Following the most recent lockdowns there was no corresponding increase to the provisions. This retailers' own changes in provisions seem to contradict its forecast of bad debts per customer.

### *Arrears data*

Throughout 2020 and 2021 electricity retailers have given the commission ongoing updates on the number of Victorian customers receiving payment assistance during the coronavirus pandemic. We have considered the level of average arrears for both residential and small business customers

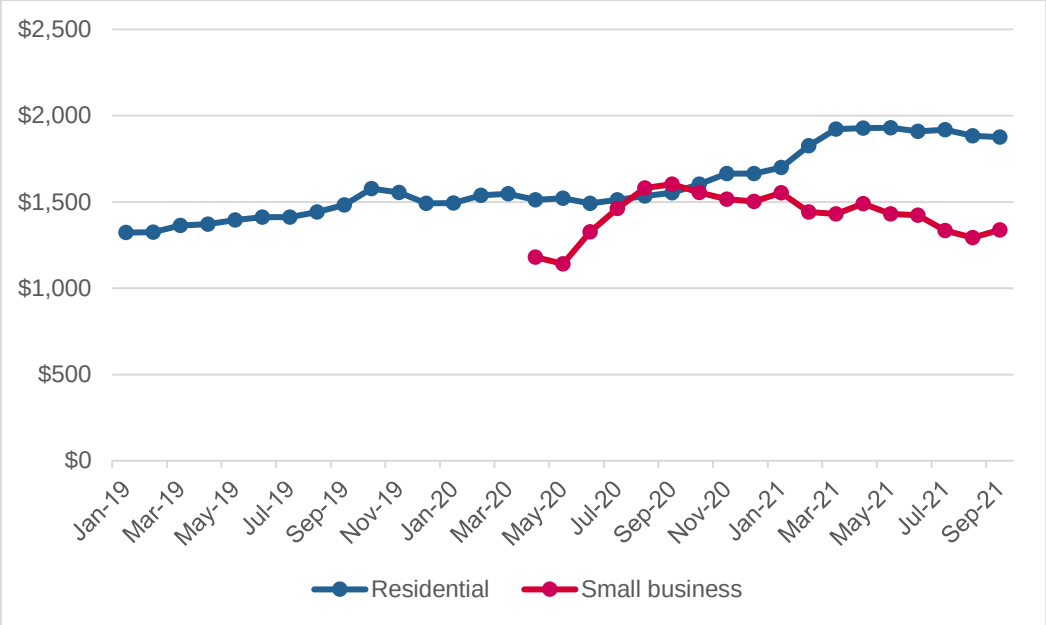
[80] Essential Services Commission, Victorian Default Offer from 1 January 2022: Draft decision, September 2021, pp. 28-29.

[81] Confidential information submitted by retailers.

[82] Confidential information submitted by retailer.

receiving payment assistance, who cannot pay for on-going usage. This may provide an indication of the trend in the level of bad or doubtful debts retailers may incur.

**Figure 9: Average arrears for customers on payment plans and cannot pay on-going usage**




Source: Energy Retailers

Notes: We began collecting data on small business customers from April 2020.

In reaching our final decision, we observed the trend in arrears between 2019 and 2021.[83] We use the amount owed by customers on payment plans that cannot pay ongoing usage as, of the data provided, this is the most likely to give an indication of potential changes in bad debt levels. For customers that cannot pay ongoing usage, the average amount owed increased during the coronavirus pandemic. Residential customers' arrears increased mostly in February and March 2021 and have remained relatively stable since (Figure 9 above shows this). Small business customers' arrears peaked in September 2020 but have been falling since (aside from a slight increase in September 2021).

Also, the number of residential electricity customers receiving tailored assistance that cannot pay on-going usage has been decreasing since it peaked in March. The number of small businesses receiving payment assistance increased between June and August this year but is now lower than it was in March 2021.

[83] We have not included data prior to 2019. The way we have collected data on customer arrears changed with the introduction of the new payment difficulty framework.

## We considered stakeholder submissions on retail costs

### Bad debts

Consumer Action Law Centre strongly support the removal of the temporary bad debt adjustment.[84] On the other hand retailers generally supported keeping the adjustment for bad debts. They noted that the extent and pace of economic recovery remains uncertain, particularly given the recent lockdowns.[85]

A baseline amount for bad debts has always been included in our retail operating cost benchmark. Our bad debt adjustment for the impact of the pandemic was intended to be a temporary adjustment for an extraordinary event. As noted above there are strong indications that economic conditions will be better in 2022 than in 2021. Further, the data available to us on retailers' total bad debt per customer suggests that there has not been a significant increase in bad debts during the course of the pandemic.

Alinta stated that there has been a reduction in government support for individuals and businesses affected by the pandemic. This could suggest that a bad debt adjustment could be more needed in 2022 than it was in 2021.[86] As discussed above, we note economic conditions are expected to be better in the first half of 2022. These forecast improvements in economic output and employment underlie our view that the temporary bad debt provisions are not required.

### Benchmarking

AGL submits the current benchmark understates retailer costs. However, AGL also submitted that the short determination period may not allow for a full review of the benchmark and supported the current approach of adjusting for inflation as a temporary measure.[87]

As discussed in our draft decision we consider the level of the benchmark is appropriate. We have updated it for inflation and cross checked it against actual data provided by Victorian retailers.

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[84] CALC, submission to the Victorian Default Offer from 1 January 2022: Draft decision, pp. 2-3.

[85] AGL, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 5; Alinta Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 2; Powershop, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 2; EnergyAustralia, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 6; Origin Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, pp. 2-4.

[86] Alinta Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 2.

[87] AGL, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 6.

Analysis of the cost data we have collected from retailers suggests the benchmark we have set represents an efficient amount for retail operating costs for retailers of different sizes.[88]

### Five-minute settlements

Powershop supports the inclusion of an ongoing amount for five-minute settlements. Powershop expects that there will be increased costs associated with metering to support the increased meter data transfer processes moving forward. Powershop submitted the Victorian Default Offer should include a capital expenditure benchmark for the investment required to meet each of the relevant regulatory and market interventions likely to be realised during a regulatory period.[89]

Our final decision on the 2021 Victorian Default Offer noted the retail margin already includes the annual cost of depreciation to update and maintain operating systems. An additional amount for capital expenditure is not needed.[90] Powershop did not provide any additional information that would lead us to reconsider our position on this matter.

### Consumer data right

In our draft decision we noted retailers' consumer data right obligations would not start until the second half of 2022 and said we would consider Consumer Data Right obligation costs in our next review. Momentum submitted it has already incurred costs for the new obligations. We note the capital expenditure, including for IT projects, is already provided for in the retail operating margin. Consumer Data Right obligations are proposed to commence on 1 October 2022, from which time retailers AGL, Origin Energy and EnergyAustralia, will need to comply. It is proposed other retailers (such as Momentum) will need to comply with these obligations in late 2023.[91] We will consider ongoing costs as part of our next review and encourage retailers to provide information to us on these costs.

## Customer acquisition and retention costs

- Our final decision is to keep our approach to estimating customer acquisition and retention costs (acquisition costs).

[88] We first used our Section 37 powers under the ESC Act to formally request cost data from retailers in September 2019. We consider the data collected via this process is fit for the purpose of determining an appropriate range for efficient costs. The most recent cost data available to us is for financial year 2019-20.

[89] Powershop, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 2.

[90] Essential Services Commission 2020, Victorian Default Offer 2021: Final decision, 25 November, p. 33.

[91] Treasury, Consumer Data Right in the energy sector: proposals for further consultation, August 2021, p. 4.

- Acquisition costs represent about three per cent of costs in the average residential bill (averaged across the five distribution zones).
- Our decision means acquisition costs in the cost stack will slightly increase due to inflation.

The pricing order requires us to consider modest acquisition costs in making our Victorian Default Offer price determination.[92] Our benchmark reflects the costs of competing for customers in a contestable retail market. These costs include the cost of acquisition channels (such as third-party comparison websites and service providers or telemarketing sales), the cost of retention teams, and marketing costs targeted at driving customer acquisition or retention.

### We have kept our approach to acquisition costs

We have set a modest benchmark for acquisition costs. The benchmark is based on cost levels from the Australian Competition and Consumer Commission's retail and electricity pricing inquiry's final report.[93] We have updated the benchmark for inflation.

It is not appropriate to use retailers' actual acquisition costs. Data suggests that the expenditure for retailers in Victoria on acquisition costs continues to grow. This increased spending benefits retailers that are able to grow their market share. However, it is still not clear how spending above the level of our benchmark benefits consumers as a group. As a result we kept our current benchmark.

### We have considered stakeholder submissions on acquisition costs

We received submissions on acquisition costs from the Consumer Action Law Centre and Powershop.

The Consumer Action Law Centre submitted that upcoming reforms will require retailers to cease costly marketing practices. It submitted that with the end of these practices the amount in the Victorian Default Offer cost stack for acquisition costs should be reduced.[94] We considered how these reforms might affect costs in our draft decision. It is not clear that the reforms will lead to a decrease in costs. Nonetheless we share the Consumer Action Law Centre's concern about increasing acquisition costs and consider that retailers should aim to lower their acquisition costs over time.

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

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

[94] CALC, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, September 2021, p.4.

Powershop's submission suggested that the amount included in the Victorian Default Offer for acquisition costs should be increased to support innovation.[95] We consider that retailers are provided with profits through the retail margin which they can choose to reinvest in innovation.

## Other costs

- Our final decision is to set a benchmark for other regulatory costs that are based on the latest available market information.
- 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 decreases 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 (around one per cent) but are a relevant factor in our estimation of the efficient costs for the sale of electricity by a retailer.[96]

### 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.

The market operator's Budget and Fees report contains budgeted fees and charges for 2021–22 but does not include forecast estimates for 2022–23.[97] We plan to apply the budgeted fees for the first half of 2022 and monitor any changes to fees introduced from 1 July 2022.

We note the recent National Electricity Rule change request by Energy Networks Australia to recover cost of the market operator's participant fees and will monitor how this change affects retailer's costs in the future.[98] Energy Australia noted in their submission that we should include the

[95] Powershop, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 3.

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

[97] Australian Energy Market Operator, 2021-22 Consolidated budget and fees report, 14 October 2021.

[98] Australian Energy Market Operator, ENA Rule change request: Recovering the cost of AEMO's participant fees, June 2021.

market operator's costs of five minute and global settlement reforms and the Distributed Energy Resources Integration program.[99] We have included these costs in this final decision.

### 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. Unlike other charges, the market operator operates separate markets for various ancillary services.

The relevant charges are dependent on the amount of service required at any particular time, which means the costs will vary from period to period. We have completed analysis of market operator data to estimate Victorian ancillary charges in the regulatory period beginning 1 January 2022. We intend to use an average of the past 52 weeks (ending 29 October 2021) of ancillary service payments in Victoria. This results in an average ancillary service payment of $0.33/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 Australian Energy Market Operator Reliability and Emergency Reserve Trader End of Financial Year Report 2020–21 contains details of activations. As there were no activations of this function in Victoria, our final decision does not include an amount for reserve trader costs.[100]

### 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 available data on licence fees is from 2020–21, which results in a benchmark of $2.16 per customer.

[99] EnergyAustralia, submission to the Essential Services Commission Victorian Default Offer from 1 January 2022 – Draft decision, September 2021, p.3-4.

[100] Australian Energy Market Operator, RERT End of Financial Year 2020-21 Report, August 2021.

## 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 decrease.

The pricing order requires us to have regard to retail operating margin when making a Victorian Default Offer price determination.[101] We considered how the pandemic will affect retailers' margins and whether the level or methodology of the retail operating margin in the Victorian Default Offer should change to reflect this. Our final decision is to maintain the approach we used to setting the retail operating margin in our last review.

### The retail operating margin provides retailers incentives to invest

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.[102] The retail operating margin is expressed as a percentage of the cost stack.[103] 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.[104] The pricing order also notes that we are not required to base the retail operating margin on actual retailer operating margins.[105]

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

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

[103] 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.

[104] Clause 12(7) of the 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.

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

### We have kept the retail operating margin at 5.7 per cent

In our last review, we kept the regulatory benchmarking approach used in our previous decisions. This approach uses recent regulatory decisions by Australian regulators to set a benchmark for a retail operating margin.

In response to stakeholder submissions from our last review, we investigated the current margins and the methodologies adopted in other jurisdictions. The range of retail margins set by Australian regulators in their latest regulatory decisions was between 5.3 to 5.7 per cent.

We also looked into the level of retail margins existing in Victoria. We analysed actual retail electricity costs from the cost data submitted by Victorian retailers. The assessment indicated that the average retail margin recovered by retailers in Victoria in the last two financial years was in line with the margin allowed in the Victorian Default Offer. This suggests that at a broad level there is no significant difference in the retail margins set by the commission for Victorian Default Offer and the existing margins in the Victorian retail electricity market.

The evidence before us does not suggest there has been a material, and ongoing, need to change the retail operating margin. As a result, we have not adjusted the retail operating margin.

We will continue to monitor the margin and market developments. We will reconsider the margin level in future decisions if there is evidence to suggest material change in the efficient retail margin.

We also looked at international regulators that set retail electricity prices. However, due to market differences between Victoria and these international jurisdictions we did not consider these values fair comparisons.

#### Undertaking detailed review of the margin

As discussed above, we undertook a review of our current methodology of the retail operating margin. We looked at other approaches used by regulators and found that there is no single approach preferred by retailers in setting the retail operating margin. We note that most approaches are based on a number of underlying assumptions around temporal and geographical comparability, as well as relationships with macro-economic factors. Some empirical approaches use data from historical mergers and acquisitions, making the accuracy of outcome reliant on the volume of market transactions.

Even if we considered a certain approach to be more robust than others, there is no guarantee that the margin we would determine using that approach would be significantly different to the current one. Our current retail operating margin is similar to the range and level of other regulators.

Our analysis of the cost data by Victorian retailers also suggests that our retail operating margin is within the range of margins in the Victorian retail electricity market. There is little evidence to suggest that there has been a material change to the efficient retail operating margin that requires us to initiate further review of the margin at this stage.

### The Victorian Default Offer and retail competition

Some retailers have previously submitted concerns about the impact of the Victorian Default Offer on retail competition.

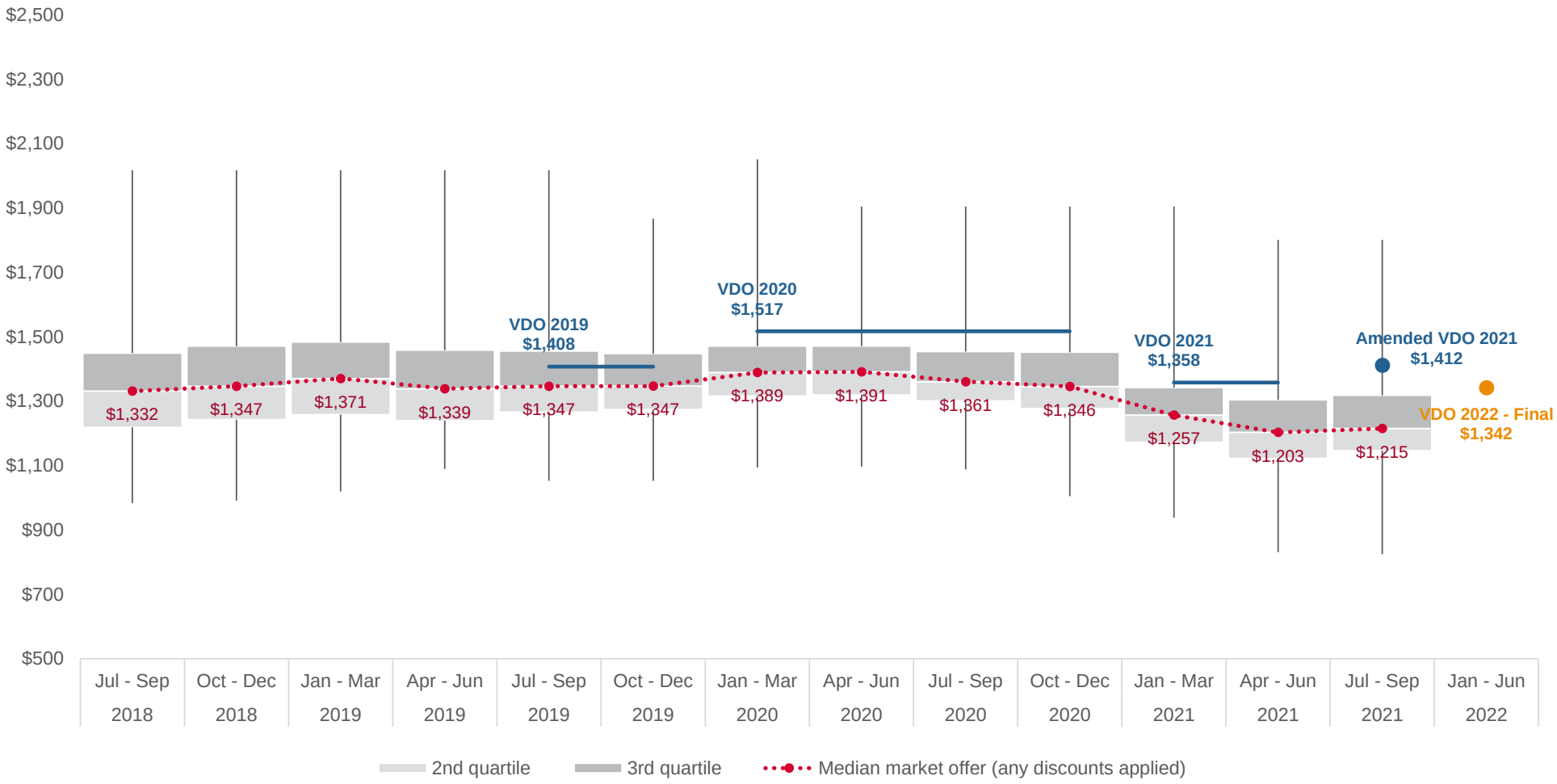
We note the Victorian Default Offer sets a price that customers on standing offers pay for retail electricity. It also acts as a reference price that makes it easier for customers to compare market offers.

Under the *Essential Services Commission Act 2001 (Vic.)*, one of the matters we must have regard to is competition in the industry.[106]

We note retailers continue to provide market offers below the Victorian Default Offer. Figure 10 below shows the average residential Victorian Default Offer price is currently above the median residential market offer. We observe a similar outcome for small business offers. This suggests the Victorian Default Offer allows competition on price.

[106] ESC Act Section 8A(1)(c).

## Figure 10 Annual residential Victorian Default Offer bill compared to market offer bills (4,000 kWh/year)



# Calculating Victorian Default Offer tariffs and maximum bills

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 maximum bill -** for standing offers with non-flat tariffs, other than two-period time of use tariffs.

The compliant maximum annual bill 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 2021 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 determination[107] and have not raised substantive issues in response to our draft decision released in September this year.[108]

### 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)

## 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 amended 2021 determination.[109] Under this approach, we align the tariff structures with the underlying two-period time of use network tariffs.

Stakeholders generally supported this approach to two-period time of use tariffs, which is the same as the one we used for our amended 2021 determination.[110] Stakeholders did not raise substantive issues with this approach in response to our draft decision released in September this year.[111]

However, Origin suggested lower consumption volume (due to greater solar penetration) would affect retail cost recovery of operating costs.[112] We note that retail operating costs are allocated to

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

[108] Essential Services Commission, Victorian Default Offer price review 2022, Draft decision, September 2021.

[109] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, pp. 9–14.

[110] Essential Services Commission, Victorian Default Offer amendment to price determination 2021: Final decision, July 2021, pp. 9–14

[111] Essential Services Commission, Victorian Default Offer price review 2022, Draft decision, September 2021.

[112] Origin Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. 7.

the daily supply charge because they are based on a fixed, annual amount per customer. In light of this, recovery of retail operating costs will not be affected by lower consumption volume.

### 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.

### 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 maximum customer bill

In addition to setting the flat and two-period time of use tariffs described above, 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.

This is consistent with the approach we took to amending the 2021 price determination. In our amended 2021 price determination, we specified that tariffs, other than the two-period time of use and flat tariffs, would be regulated through the compliant maximum annual bill. The compliant maximum annual bill amount is calculated based on the two-period time of use tariffs.

Retailers offering non-flat standing offer tariffs must make sure their tariffs do not result in a bill above the compliant maximum annual bill at a specific usage 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.

### 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

Our final decision uses the same usage profiles for calculating the compliant maximum annual bill amounts as we used in the amendment of the 2021 decision. These usage profiles are in the tables below. We used manually read interval meter data provided by the Australian Energy Market Operator to calculate these profiles.

#### Table 4: 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 |

#### Table 5: 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 | 0.49 | 0.51 |

### 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 and relevant usage profiles as specified above for domestic and small business customers and applying the two-period time of use tariff, as determined by the commission, for that customer in the relevant distribution zone, for an assumed supply period of 365 days.

### 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 exceed the relevant compliant maximum annual bill amount. The retailer must use a 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. It must also reflect the retailer's relevant published representative usage profile.

### Publication requirements for standing offer tariffs regulated by the compliant maximum annual bill

Retailers are required to publish all standing offer tariffs on their websites and on Victorian Energy Compare.[113] In our determination for the 1 January 2022 Victorian Default Offer we have removed the requirement for retailers to gazette their representative usage profiles for standing offer tariffs regulated by the compliant maximum annual bill. However, we request retailers publish those usage profiles on their websites and submit the profiles to VDO@esc.vic.gov.au.

### We considered stakeholders' submissions on the maximum bill

Stakeholders have not raised issues with our approach to calculating the compliant maximum bill amount in response to our 2022 draft decision.[114]

[113] Energy Retail Code clause 15A and Electricity Industry Act Division 5.

[114] Essential Services Commission, Victorian Default Offer price review 2022, Draft decision, September 2021.

# Length of the regulatory period

- Our final decision is to set the 2022 Victorian Default Offer regulatory period for the six months from 1 January 2022 to 30 June 2022.

The pricing order sets the regulatory period for a Victorian Default Offer price determination to 12 months. Up to now regulatory periods have normally run over calendar years. However, the pricing order allows for the regulatory period to be longer or shorter by six months in special cases.

### Network tariffs change each financial year

In 2020, the regulatory periods for the Victorian network businesses began to run on financial years. However, as stated above the Victorian Default Offer has run on a calendar year cycle. The next regulatory period must start from 1 January 2022.

### For practical reasons we will set prices for a 6-month period

Network costs are the largest part of the Victorian Default Offer cost stack. In this decision they cover about 39 per cent of costs in the average residential bill. Given the large impact network tariffs have on Victorian Default Offer prices, Victorian Default Offer regulatory periods should match network regulatory periods.

We consider a 6-month regulatory period best serves the long-term interests of Victorian consumers. A 6-month regulatory period will provide the quickest alignment between Victorian Default Offer regulatory periods and network tariff regulatory periods. A 6-month period is also supported by most stakeholders.[115] Consequently, our final decision is to set the regulatory period for the 1 January 2022 Victorian Default Offer to six months.

[115] Victorian Council of Social Service, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p.1; Simply Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p.1; Red and Lumo Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p.3; Powershop, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p.1; Momentum Energy, submission to the Victorian Default Offer from 1 January 2022: Draft decision, pp. 2-3; AGL, submission to the Victorian Default Offer from 1 January 2022: Draft decision, p. i.

As required under the pricing order, we consulted with the Minister for Energy, Environment and Climate Change on the length of the regulatory period.[116] The Minister noted broad support from stakeholders for a 6-month period (letter available on our website).[117]

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

[117] The Honourable Lily D'Ambrosio Minister for Energy Environment and Climate Change, Change to regulatory period for Victorian default offer to align with network tariffs, 11 August 2021.

# Appendix A: Network tariffs in the cost stack

### Table A.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 A.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 A.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 B: 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 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 allowance for volatility.

These costs vary across Victoria as a result of different customer load profiles in each distribution zone. Calendar year 2022 estimates of the wholesale electricity price and volatility allowance for each zone are displayed in the table below.

**Table B.1: Wholesale electricity forecasts for 2022, as of 22 October 2021 (GST exclusive)**

| Distribution zone | Domestic | | Small business | |
|---|---|---|---|---|
| | Wholesale price - 12 month ($/MWh nominal) | Volatility allowance ($/MWh nominal) | Wholesale price - 12 month ($/MWh nominal) | Volatility allowance ($/MWh nominal) |
| AusNet Services | $71.42 | $0.27 | $62.76 | $0.23 |
| CitiPower | $67.80 | $0.28 | $63.89 | $0.22 |
| Jemena | $73.68 | $0.27 | $63.96 | $0.22 |
| Powercor | $69.78 | $0.28 | $61.05 | $0.18 |
| United Energy | $74.19 | $0.30 | $65.22 | $0.23 |

Source: Frontier Economics, Wholesale electricity costs for 2022, 22 October 2021

## 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 have calculated the total loss factor based on the 2021-22 distribution and marginal loss factors published by Australia Energy Market Operator.[118]

**Table B.2: Network losses**

| Distribution zone | Distribution loss factor (DLF) | Marginal loss factor (MLF) | Total loss factor |
|---|---|---|---|
| AusNet Services | 1.0734 | 1.0056 | 7.95% |
| CitiPower | 1.0500 | 0.9979 | 4.78% |
| Jemena | 1.0430 | 0.9993 | 4.23% |
| Powercor | 1.0782 | 0.9938 | 7.15% |
| United Energy | 1.0525 | 0.9957 | 4.79% |

Source: Australian Energy Market Operator, Distribution Loss Factors and Marginal Loss Factors 2021-22

## 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 B.3 and B.4 show the Australian Energy Regulator approved flat network tariffs for the period 1 July 2021 to 30 June 2022 for the purposes of our final decision.

**Table B.3 Domestic electricity network charges, flat tariff, 2022 (GST exclusive)**

| Distribution zone | Daily charge ($ per year) | Variable charge structure | Variable charge ($ per kWh) | Controlled load ($ per kWh) |
|---|---|---|---|---|
| AusNet Services | $111.11 | Block 1<br>Block 2 | $0.1145<br>$0.1284 | $0.0426 |
| CitiPower | $90.01 | Anytime | $0.0805 | $0.0247 |
| Jemena | $82.20 | Anytime | $0.0867 | $0.0360 |
| Powercor | $139.98 | Anytime | $0.0815 | $0.0239 |

[118] Australian Energy Market Operator, Distribution Loss Factors for the 2021-22 Financial Year, July 2021, p. 13; Citipower, Powercor & United Energy, response to Distribution data: solar export and transmission lines, July 2021; AusNet, response to request on Ausnet data - solar export and transmission lines, July 2021; Australian Energy Market Operator, Marginal Loss Factors for the 2021-22 Financial Year, July 2021, pp. 24-29.

| | | | | |
|---|---|---|---|---|
| United Energy | $80.01 | Anytime | $0.0799 | $0.0217 |

Source: Victorian distribution businesses' Australian Energy Regulator approved 2021–22 pricing proposals.

### Table B.4 Small business electricity network charges, flat tariff, 2022 (GST exclusive)

| Distribution zone | Daily charge ($ per year) | Variable charge structure | Variable charge ($ per kWh) |
|---|---|---|---|
| AusNet Services | $111.11 | Block 1<br>Block 2 | $0.1554<br>$0.1827 |
| CitiPower | $160.02 | Anytime | $0.0821 |
| Jemena | $134.47 | Anytime | $0.1097 |
| Powercor | $179.98 | Anytime | $0.0929 |
| United Energy | $120.01 | Anytime | $0.0879 |

Source: Victorian distribution businesses' Australian Energy Regulator approved 2021–22 pricing proposals.

Tables B.5 and B.6 show the Australian Energy Regulator approved two-period network tariffs for the period 1 July 2021 to 30 June 2022 for the purposes of our final decision.

### Table B.5 Domestic electricity network charges, two-period time of use network tariffs, 2022 (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 | $111.11 | $0.2085 | $0.0434 | $0.0426 |
| CitiPower | $90.01 | $0.1594 | $0.0398 | $0.0247 |
| Jemena | $82.20 | $0.1349 | $0.0389 | $0.0360 |
| Powercor | $139.98 | $0.1587 | $0.0396 | $0.0239 |
| United Energy | $80.01 | $0.1579 | $0.0395 | $0.0217 |

Source: Victorian distribution businesses' Australian Energy Regulator approved 2021–22 pricing proposals.

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

| Distribution zone | Daily charge ($ per year) | Peak variable charge ($ per kWh) | Off-peak variable charge ($ per kWh) |
|---|---|---|---|
| AusNet Services | $111.11 | $0.1751 | $0.0427 |

| | | | |
|---|---|---|---|
| CitiPower | $160.02 | $0.1302 | $0.0289 |
| Jemena | $242.12 | $0.1433 | $0.0305 |
| Powercor | $179.98 | $0.1475 | $0.0328 |
| United Energy | $120.01 | $0.1399 | $0.0311 |

Source: Victorian distribution businesses' Australian Energy Regulator approved 2021–22 pricing proposals.

Table B.7 shows the Australian Energy Regulator approved network metering charges from 1 July 2021 to 30 June 2022.

**Table B.7 Network metering charges, 2022 (GST exclusive)**

| Distribution business | Annual metering charge ($ per customer) |
|---|---|
| AusNet Services | $63.70 |
| CitiPower | $59.40 |
| Jemena | $54.19 |
| Powercor | $58.00 |
| United Energy | $42.92 |

Source: Victorian distribution businesses' Australian Energy Regulator approved 2021–22 pricing proposals.

## Under or over recovered network costs for July and August 2021

Box B.1 illustrates our approach to estimating under or over recovered network costs for the months of July and August 2021 for customers on the flat tariff and two-period time of use tariffs.

Table B.8 shows the usage we used for estimating under or over recovered network costs for each distribution zone and customer type.

To establish usage profiles, we used Manually Read Interval Meter (MRIM) data provided by the Australian Energy Market Operator (market operator) for the period 1 July 2021 to 31 August 2021. The data has been filtered by the market operator to only capture customers relevant to the Victorian Default Offer, that is, residential and small business customers using up to 40MWh per year. Noting the MRIM data aligned with AEST we included an adjustment for daylight savings in Victoria. For each distribution zone, we calculated the proportion of total volume of electricity peak and off-peak loads consumed during the specified peak and off-peak periods. To calculate Victoria wide profiles for both residential and small business customers, we used a simple average of the profiles of each of Victoria's five distribution zones.

## Box B.1: Detailed methodology for network cost true up from 1 January 2022

**Detailed methodology for network cost true up in 2022 VDO**

| TARIFF | CALCULATION | | ALLOCATION | |
|---|---|---|---|---|
| **Flat rate true up** | **True up cost $** | (Fixed cost $ + Variable cost $) x (1+GST) x (1+ROM) | **True up tariff** | Fixed tariff $/day |
| | **Fixed cost $** | (Supply + metering charges 2021 Variation) – (Supply + metering charges 2021 VDO) **x** No. of days[1] | **Fixed tariff $/day** | True up cost **/ No. of days**[3] |
| | **Variable cost $** | (Usage charge 2021 Variation **–** Usage charge 2021 VDO) **x** Actual usage[2] | | |
| **CL true up** (Residential only) | **True up cost $** | Variable cost $ x (1+GST) x (1+ROM) | **True up tariff** | Variable tariff $/kWh |
| | **Variable cost $** | (Usage charge 2021 Variation – Usage charge 2021 VDO) **x** Annual usage[4] | **Variable tariff $/kWh** | True up cost **/ Annual usage**[5] |
| **TOU true up** | **True up cost $** | (Fixed cost $ + variable cost $) + (1+GST) x (1+ROM) | **True up tariff** | Fixed tariff $/day |
| | **Fixed cost $** | (Supply + metering charges 2021 Variation) – (Supply + metering charges 2021 VDO) **x** No. of days[1] | **Fixed tariff $/day** | True up cost **/ No. of days**[3] |
| | **Variable cost $** | (Usage Peak charge 2021 Variation **x** Actual Peak usage[6]) **+** (Usage Off-peak charge 2021 Variation **x** Actual Off-peak usage[6]) **–** (CMAB usage charge 2021 VDO **x** Actual usage[2]) | | |

Notes

[1] Number of days from 1 July to 31 August 2021.

[2] Actual general usage per customer in July and August 2021 using total usage from Australian Energy Market Operator and total Victorian customers as at 30 June 2021.

[3] Number of days from 1 January to 30 June 2022.

[4] Based on two-month load weighted proportion of controlled load usage. We used Victoria's load profile for 2020-21 taken from Manually Read Interval Meter data as the basis for the weighting factors.

[5] Based on 6-month load weighted proportion of controlled load usage. We used Victoria's load profile for 2020-21 taken from Manually Read Interval Meter data as the basis for the weighting factors.

[6] Actual general usage in July and August 2021 proportioned for peak and off-peak using total usage from Australian Energy Market Operator and total Victorian customers as at 30 June 2021.

### Table B.8: Total usage in Victoria in July and August 2021, domestic and small business customers, kWh

| Month | Domestic usage | Small business usage |
|---|---|---|
| July 2021 | 1,390,862,726 | 213,022,007 |
| August 2021 | 1,178,856,386 | 181,159,117 |
| Total | 2,569,719,112 | 394,181,125 |

Source: Australian Energy Market Operator

The market operator does not report on the actual usage data for customers with controlled load in Victoria. Instead, we have based the under or over recovered network costs for controlled load tariffs on load weighted monthly usage. We used Victoria's load profile taken from Manually Read Interval Meter data as the basis for the load weighting.[119] We consider this approach better reflects controlled load customers' electricity demand for the months of July and August. This leads to total usage of 485 kWh for July and August 2021.[120]

Tables B.9, B.10 and B.11 show our estimated true ups for customers on the flat tariff, two-period time of use tariffs and controlled load tariffs.

### Table B.9 Electricity true up, flat tariff, 2022 (GST inclusive)

| Distribution zone | Domestic customers | Small business customers |
|---|---|---|
| AusNet Services | $11.94 | $25.62 |
| Citipower | $16.19 | $9.23 |
| Jemena | $14.09 | $26.52 |
| Powercor | $14.09 | $11.83 |
| United Energy | $6.36 | -$0.73 |
| Victoria (average) | $12.53 | $14.49 |

[119] Network System Load Profile provides data for all accumulation meters only. We have used compared this data with the Controlled Load Profiles for New South Wales and South Australia. See: Australian Energy Market Operator, Victorian MRIM meter data, accessed 26 October 2021, https://aemo.com.au/energy-systems/electricity/national-electricity-market-nem/data-nem/metering-data/victorian-mrim-meter-data.

[120] Annual usage profile for these controlled load customers in the Victorian Default Offer pricing order of 2000 kWh multiplied by controlled load usage – true up proportion of 24.27 per cent (covering the months of July and August).

### Table B.10 Electricity true up, TOU tariff, 2022 (GST inclusive)

| Distribution zone | Domestic customers | Small business customers |
|---|---|---|
| AusNet Services | -$6.40 | -$59.60 |
| Citipower | $14.83 | $3.65 |
| Jemena | -$3.71 | $10.34 |
| Powercor | $11.22 | $5.72 |
| United Energy | $4.89 | -$6.20 |
| Victoria (average) | $4.16 | -$9.22 |

### Table B.11 Electricity true up, controlled load tariff, 2022 (GST inclusive)

| Distribution zone | Domestic customers |
|---|---|
| AusNet Services | $2.27 |
| Citipower | $2.15 |
| Jemena | $3.87 |
| Powercor | $1.42 |
| United Energy | $2.49 |
| Victoria (average) | $2.44 |

## 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 will not set the Renewable Power Percentage for 2022 until March 2022. As an alternative the Clean Energy Regulator provides an approach for calculating a default Renewable Power Percentage. We have engaged Frontier Economics to estimate the cost of complying with the Large-scale Renewable Energy Target. This includes estimating the default Renewable Power Percentage for 2022 (18.54 per cent) and

calculating the 12-month average of 2021 futures market prices for certificates (LGCs) as reported by Demand Manager.[121]

### 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 does not publish the binding small-scale technology percentage until March 2022. However, it has published the non-binding small-scale technology percentage for 2022 at 22.40 per cent.[122] The actual binding small-scale technology percentage for 2021 was set at 28.80 per cent.

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.

To set a benchmark for the Small-scale Renewable Energy scheme costs, we have used the mid-point of the non-binding small-scale technology percentage for 2022 and the binding small-scale technology percentage for 2021, multiplied by the clearing house price. We have also included an adjustment for the level of the difference between the forecast small-scale technology percentage we used in the 2021 Victorian Default Offer and the actual binding small-scale technology percentage for 2021.

We note that there have historically been significant differences between the non-binding small-scale technology percentage and the binding amount. To the extent there is a difference we will account for this through a true-up mechanism.

### 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 reference price year being assessed. As the greenhouse gas reduction rate for 2022 is not available at the time of our final decision, we used the rate for 2021 of 0.17255.

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[121] Demand Manager, Certificate prices, accessed 8 October 2021, http://demandmanager.com.au/certificate-prices.

[122] Clean Energy Regulator, The small-scale technology percentage, accessed 3 November 2011, http://www.cleanenergyregulator.gov.au/RET/Scheme-participants-and-industry/the-small-scale-technology-percentage.

The cost of certificates under the Victorian Energy Upgrades program is estimated from the trade-weighted average of historic market prices. Based on the information available as at 17 October 2021, we estimate an average price of $56.94 per certificate for 2022.

Our estimate of the average price per certificate is $24.56 higher than the estimate used to calculate Victorian Energy Upgrades costs for the 2021 Victorian Default Offer. This has increased the benchmark for Victorian Energy Upgrades costs in our final decision compared to the 2021 Victorian Default Offer and is reflected in an increase in both the residential and small business average annual bills.

### Feed-in Tariff (social cost of carbon)

The impact of the social cost of carbon on retailer costs is based on total small-scale renewable exports in 2020-21 and customer numbers in 2020-21 multiplied by the social cost of carbon (2.5 cents).

**Table B.12: Cost of complying with Environmental Schemes (GST exclusive)[123]:**

| Environmental scheme | Certificate price, $/MWh | Scheme liability, % | Cost, $/MWh |
|---|---|---|---|
| Large-scale Renewable Energy Target | $34.44 | 18.54% | $6.39 |
| Small-scale Renewable Energy Scheme | $40.00 | 25.60% | $10.24 |
| Victorian Energy Upgrades | $56.94 | 17.26% | $9.82 |
| Feed-in Tariff (social cost of carbon) | | | $13.34/customer |
| Small-scale Renewable Energy Scheme true up adjustment (GST inclusive) | | | $3.40 |
| Large-scale Renewable Energy Target true up adjustment (GST inclusive) | | | -$0.13 |

Source: ESC analysis and Frontier Economics, Wholesale electricity costs for 2021: 27 August 2020, pp 50-52.

[123] Costs other than Feed-in Tariff (social cost of carbon) have been multiplied by network loss factors.

## 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 have used a benchmark of $141.75 for retail operating costs and $39.62 for customer acquisition and retention costs (see table B.13).

### 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 B.13: Retail costs and margin (GST exclusive)

| Retail costs and margin | Annual benchmark |
|---|---|
| Retail operating costs | $141.75 |
| Customer acquisition and retention costs | $39.62 |
| 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 Budget and Fees report.[124] The estimate of our licence fee is a market-wide average based on the approved fees for the year 2021-22. We have adopted a forecast of ancillary charges based on analysis of the past 12 months of ancillary service cost data.

#### Table B.14: Other costs (GST exclusive)

| Charge | Rate |
|---|---|
| Essential Services Commission licence fee [125] | $2.16/customer |
| **Australian Energy Market Operator fees** | |

[124] Australian Energy Market Operator, 2021-22 AEMO Final Budget and Fees.

[125] The Essential Services Commission licence fee has been adjusted for inflation.

| Charge | Rate |
|---|---|
| National Electricity Market fees | $0.40/MWh |
| Full retail contestability | $1.35/customer |
| National Transmission Planner | $0.00/MWh |
| Five-minute and global settlement compliance fees | $0.12/MWh |
| Distributed energy resources integration program fees | $0.03/MWh |
| Energy Consumers Australia | $0.62/customer |
| Ancillary services | $0.33/MWh |
| Reliability and Emergency Reserve Trader | $0.00/customer |
| **Total per MWh:** | **$0.88/MWh** |
| **Total per customer:** | **$4.12/customer**[126] |

[126] Values in the table do not sum to exact total due to rounding.

# Appendix C: 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 chapter 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.[127] 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.[128]

Further, the Victorian Default Offer price determination must be based on the efficient costs of the sale of electricity by a retailer,[129] having regard to:[130]

- wholesale electricity costs
- network costs
- environmental costs
- retail operating costs, including only modest costs of customer acquisition and retention[131]
- retail operating margin[132]
- any other costs, matters or things we consider appropriate or relevant.

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

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

[129] Clause 12(3) of the 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.

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

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

[132] 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.

The pricing order also specifies that we must not include headroom.[133]

## 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.[134]

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 outlined below, 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;

[133] 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.’

[134] Clause 3 of the order sets out the objective of the Victorian Default Offer.

- 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;
- consistency in regulation between States and on a national basis;
- any matters specified in the empowering instrument (i.e. the pricing order; see discussion above).

Section 33 of the ESC Act only applies to the extent it is not contrary to the pricing order.[135] 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.[136]

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 (i.e. retail electricity market) and the prescribed goods and services (i.e. 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.[137]

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

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

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

# Appendix D: How we assessed the Victorian Default Offer

Appendix C sets out the requirements for and matters we must have regard to in making a Victorian Default Offer price determination. This chapter summarises, how we have considered these matters.

## Our approach to this review

In coming to our final decision on the Victorian Default Offer, we have built on our 2021 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 2021 price determination and the following variation. 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. 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 C).

### We analysed the efficient costs of electricity retailers

Through issuing notices under our compulsory information gathering powers, we collected cost data from electricity retailers. This information allowed us to understand the types of costs electricity retailers incur and elements of the efficient costs of supplying electricity to customers. We sought advice from independent consultants on forecasting retailers' wholesale electricity costs and of retailers' costs of complying with environmental programs for 2022.

Our approach and methodology includes the elements listed below to estimate the efficient costs of the sale of electricity by a retailer.[138]

- **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

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

- **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 the impact of the coronavirus pandemic and other changes

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.[139]

Among other things, our review has taken into consideration the impact of the coronavirus pandemic (the pandemic) on retailers and the retail electricity market.

Through stakeholder submissions we heard many Victorian residential and small business customers are experiencing vulnerability because of the pandemic, including payment difficulties. We have considered the information available on the impact on the retail electricity market. 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.

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

We also had regard to other changes in the regulatory environment that may affect retailers' efficient costs: for example changes due to five-minute settlement and the consumer data right.

### 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 have included a two period time of use that will cover most non-flat standing offers. However we have also included 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 have 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.[140] We also consider this arrangement provides a framework that does not impose unreasonable costs on retailers.[141] As with other elements of our methodology, we have also had regard to the approaches adopted by other regulators including the Australian Energy Regulator's Default Market Offer.[142]

## 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.[143]
- 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. [144]

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

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

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

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

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

[144] Section 8 of the ESC Act.

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.

### 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.[145] We have had regard to all of these matters in coming to our final decision.

#### *Efficiency*

Efficiency is an important consideration for our decision.[146] 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.[147] Our review used largely the same approach as our 2021 price determination and the amendment to that determination.

#### *Financial viability*

A related matter is the consideration of long-term incentives for investment and financial viability.[148] 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.[149]

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

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

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

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

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

*The relevant legislation applying to the industry*

We considered other legislation that affects the efficient costs of a retailer.[150] 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 and five-minute settlements). We also note that our benchmarks of retailer operating costs, CARC and retail operating margin reflect the costs and margins of Australian retailers complying with regulatory and legislative requirements.

*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.[151] In formulating the Victorian Default Offer we are not required to revisit the costs and benefits of implementing the Victorian Default Offer.[152]

We have, however, had regard to the costs and benefits of regulation in our approach to formulating the Victorian Default Offer.[153] 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 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.

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

[151] 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.

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

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

*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.[154]

*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.[155] 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.

*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.[156] 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 have considered this guidance in making our decision. The relevant matters are considered in the body of our decision including the cost stack chapter, chapter on flat tariffs and maximum bill, and earlier in this appendix.

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

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

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

# Appendix E: submissions on the draft decision

| Name of organisation | Date received |
|---|---|
| Mike Russell | 08/09/2021 |
| Anonymous 1 | 10/09/2021 |
| Origin | 08/10/2021 |
| Victorian Council of Social Service | 08/10/2021 |
| EnergyAustralia | 08/10/2021 |
| Red & Lumo | 08/10/2021 |
| AGL | 08/10/2021 |
| Alinta | 08/10/2021 |
| Powershop, Meridian | 08/10/2021 |
| Consumer Action Law Centre | 08/10/2021 |
| Momentum | 08/10/2021 |
| Simply Energy | 08/10/2021 |

# Appendix F: 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)<br>Block 2 (> 1020 kWh during a quarter) | $0.2763<br>$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)<br>Block 2 (> 1020 kWh during a quarter) | $0.3154<br>$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 G: changes to cost stack

Table G.1 shows how our cost stack has or has not changed compared to the 2021 Victorian Default Offer (as amended) and the 2022 Victorian Default Offer draft decision.

**Table G.1: changes between 2021 decision and 1 January 2022 draft/final decisions**

| Item | 2021 Victorian Default Offer (as amended) to 2022 Victorian Default Offer draft decision | 2022 Victorian Default Offer draft decision to final decision |
|---|---|---|
| **Victorian Default Offer costs** | | |
| Wholesale electricity costs | No change, except that we used listed cap contracts designed for five-minute settlement as base $300 cap contracts are no longer available from ASX Energy. | Generally the same, except that:<br>we used the weighted average of the short and long sub-transmission factors for calculating distribution losses to apply to both AusNet and Powercor regions<br>We removed some transmission nodes that do not have residential or small business load in calculating the marginal loss factor. |
| Network costs | No change, except that we allow under or over recovered network costs in July-August 2021 to be recovered over the period of six months starting 1 January 2022. | Generally the same approach except we have used a load weighted average to estimate the true up for controlled load usage. |
| Environmental costs | No change | No change |
| Retail operating costs | No change | No change, except that we removed the $6 temporary adjustment for bad debts. |
| Customer acquisition and retention costs | No change | No change |
| Other costs | No change | No change, except that we included the Australian Energy Market Operator's charges for Distributed Energy Resources Integration Program and five-minute settlement. |
| Retail operating margin | No change | No change |
| **Other matters** | | |

| | | |
|---|---|---|
| Tariffs and structure | No change | No change |
| Regulatory period | 6 months instead of 12 months | 6 months |

### Table G.2: Changes in average residential costs benchmarks ($nominal)

| Item | 2021 Victorian Default Offer (as amended) | 2022 Victorian Default Offer draft decision | 2022 Victorian Default Offer final decision |
|---|---|---|---|
| Wholesale electricity costs | $399 | $301 | $303 |
| Network costs | $511 | $524 | $523 |
| Environmental costs | $109 | $119 | $138 |
| Retail operating costs | $144 | $147 | $142 |
| Customer acquisition and retention costs | $38 | $39 | $40 |
| Other costs | $9 | $7 | $8 |
| Retail operating margin | 5.7% | 5.7% | 5.7% |