

2024-25 Victorian Default Offer: Request for Comment

The Victorian Default Offer regulates standing offer prices

The Victorian Default Offer was introduced by the Victorian Government in a Governor in Council Order made under section 13 of the *Electricity Industry Act 2000* (pricing order).¹ The Victorian Default Offer regulates standing offer prices for electricity in Victoria supplied and sold to domestic customers or small business customers. The first Victorian Default Offer was set by the Victorian Government in 2019 based on advice prepared by the Essential Services Commission. Our first determination of Victorian Default Offer prices came into effect 1 January 2020. We have been responsible for setting Victorian Default Offer prices since then.

The Victorian Default Offer provides a safeguard for customers

As a reasonably priced electricity option, based on the efficient costs of the sale of electricity by a retailer, the Victorian Default Offer provides an important safeguard for consumers that are unable or unwilling to engage in the electricity retail market.

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 new contract
- moved into a new address and uses electricity without entering into a contract
- specifically asked for a standing offer
- moved onto a standing offer after their market offer contract came to an end.

¹ The Order in Council made under section 13 of the *Electricity Industry Act 2000* was published in the Victorian Government Gazette No. S 208 on Thursday 30 May 2019.

The Victorian Default Offer specifies the prices that may be charged for standing offers. As of June 2023 around 382,000 households and 58,000 small businesses were on standing offers.² This represents around 14 per cent of households and 20 per cent of small businesses.

Since September 2020, the Victorian Default Offer has also applied as a maximum price for most embedded network customers (covering around 150,000 customers).³ Electricity providers in embedded networks may set prices below the Victorian Default Offer.

The Victorian Default Offer also acts as a comparison price

Most customers are on market contracts, not standing offers. Market offers often have prices below the Victorian Default Offer.

The Victorian Default Offer plays a key role as a benchmark price for these market offers. Retailers must compare their market offers to the default offer prices when advertising. This enables customers to easily compare market offer prices and choose a plan that best suits their needs.

We review prices before the end of each regulatory period

We released our previous price determination on 25 May 2023 for the Victorian Default Offer to apply from 1 July 2023 to 30 June 2024. We refer to these arrangements for standing offers as the 2023–24 Victorian Default Offer.

Under the pricing order, we must make a new price determination for the Victorian Default Offer to apply from 1 July 2024 to 30 June 2025 on, or before, 24 May 2024.⁴ We refer to these new pricing arrangements for standing offers as the 2024–25 Victorian Default Offer.

We seek submissions on matters to consider during our next price review

The commission must adopt an approach and methodology that meets our objectives under the Essential Services Commission Act 2001⁵, the Electricity Industry Act 2000⁶, and the pricing order⁷.

² Essential Services Commission, Energy Market Dashboard, available at: <https://www.esc.vic.gov.au/electricity-and-gas/market-performance-and-reporting/victorian-energy-market-report/energy-market-dashboard> .

³ Embedded networks supply electricity for many domestic and small business customers in apartment buildings, caravan parks or office blocks.

⁴ Clause 10(1) of the pricing order.

⁵ To promote the long term interests of Victorian consumers having regard to the price, quality and reliability of retail electricity services. See the Essential Services Commission Act 2001, s8.

⁶ Being to facilitate the development of full retail competition, and to promote protections for customers including in relation to assisting customers who face payment difficulties. See the Electricity Industry Act 2000, s10.

⁷ To provide a simple trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market. See clause 3 of the pricing order.

In addition, the tariffs we determine must be based on the efficient cost of the sale of electricity by a retailer.

In our final decision on the 2023–24 Victorian Default Offer we committed to beginning our public consultations on Victorian Default Offer decisions by releasing brief ‘request for comment’ papers.⁸ These papers are intended to streamline the early stages of our Victorian Default Offer consultation processes and provide an early indication on review timelines. These papers ask for submissions on matters which stakeholders suggest we could consider as part of our review.

We will consider all submissions, and where we think a suggestion may align with the objectives and requirements of the Victorian Default Offer legislative framework we will consider the suggestion in this review. If the timelines for this review cannot accommodate this, we will consider the matter in future reviews. We note that the review periods for the Victorian Default Offer are relatively short. As a result, in some instances suggestions may need to be considered over the course of more than one review.

Stakeholders will be able to make submissions on our draft decision paper, and we will have regard to these submissions when we make our final decision and determination.

Table 1: 2024–25 Victorian Default Offer review timeframes

Key milestones	Indicative date
Request for comment paper	2 November 2023
Submissions on request for comment paper close	14 December 2023
Draft decision paper released	March 2024
Public forum on the draft decision paper	March/April 2024
Final decision and determination	Made by 24 May 2024

We propose to use generally the same methodologies as in past reviews

An overview of the methodologies we use can be found in our final decision paper on the 2023–24 Victorian Default Offer.⁹ We seek stakeholders’ views on our methodologies, but note that changes will only be made where there is strong evidence that a change would better meet the objectives and requirements of the Victorian Default Offer legislative framework.

While we welcome submissions on any of the methodologies we use to set our cost benchmarks, in our last review we committed to engaging with stakeholders on potential alternative approaches

⁸ Essential Services Commission, Victorian Default Offer 2023–24: Final Decision Paper, p. 56, 25 May 2023.

⁹ Essential Services Commission, Victorian Default Offer 2023–24: Final Decision Paper, pp. 11-55, 25 May 2023.

we could consider to set the retail margin.¹⁰ Since our last review, some stakeholders also suggested that we should consider contracting strategies for peak wholesale electricity prices.

Alternatives to peak swap wholesale electricity futures contracts

We set our benchmark for wholesale electricity costs based on futures contract prices on ASX Energy. The prices we use for contracts are based on the 12-month trade-weighted average price on ASX Energy. We have consulted widely on this approach over the last six Victorian Default Offer reviews and are of the view that it remains appropriate for the 2024-25 Victorian Default Offer. However, we have made relatively small adjustments to this approach in the past where there was strong evidence to do so.

In our final decision on the 2023-24 Victorian Default Offer, we did not include peak swap contracts in the estimation of our wholesale electricity cost benchmark. This was based on evidence we gathered from retailers and publicly available information we observed that indicated ASX Energy peak swap contracts were no longer traded in meaningful volumes.¹¹

Given this change, Frontier's STRIKE model included a larger number of base cap and base swap contracts in the wholesale electricity cost benchmark.¹² However, some stakeholders have told us that retailers are now using different instruments (such as over the counter contracts) to manage their peak wholesale price risk.

While we consider that our general approach remains sound, we are interested in submissions from stakeholders on the new instruments and strategies that retailers are now using to manage peak wholesale price risk instead of peak swap contracts.

As in past reviews we plan on using our information gathering powers to collect cost data from retailers. In addition to submissions from stakeholders, we will have regard to this information in making our draft decision. To the extent that there is evidence that retailers are making material use of different instruments to manage their peak price risk we encourage submissions to include consideration of whether and how our benchmark might be practically refined to take these into account.

¹⁰ Essential Services Commission, Victorian Default Offer 2023–24: Final Decision Paper, p. 49, 25 May 2023.

¹¹ Essential Services Commission, Victorian Default Offer 2023–24: Final Decision Paper, pp. 13 – 14, 25 May 2023.

¹² Frontier Economics, Wholesale electricity costs for 2023–24: A final report for the Essential Services Commission, May 2023.

Retail operating margin

The pricing order requires us to have regard to the retail operating margin when making a Victorian Default Offer price determination.¹³ Further, in terms of the costs we include in the Victorian Default Offer, the pricing order also specifies that we must not include headroom; that is, an allowance that does not reflect an efficient cost borne by firms operating in the market.¹⁴

For the 2023–24 Victorian default Offer, we set the retail margin at 5.3 per cent based on benchmarks set by other regulators and having regard to the expected returns model.¹⁵

The retail operating margin accounts for a relatively small share of the costs that make up the Victorian Default Offer. As the retail operating margin is expressed as a percentage of the cost stack, the dollar amount of the benchmark margin varies based on movements in other costs (such as wholesale and network costs).

As noted above, in our final decision for the 2023-24 Victorian Default Offer, we committed to engaging with stakeholders on alternative approaches to set the retail operating margin. This was in response to submissions noting the potential for circularity if regulators continue to use benchmarks set by other regulators.

Accordingly, we are seeking suggestions from stakeholders on potential alternative approaches for us to consider in setting the retail operating margin. Any suggestions for alternative approaches should also include consideration of how practical those approaches are to implement and how they might better meet the requirements and objectives of the Victorian Default Offer legislative framework compared to the current approach. We will only adopt a new approach if it better meets these requirements and objectives, and it is also practical to implement.

In past reviews the commission has considered different options for assessing the retail operating margin benchmark.¹⁶

Stakeholders may wish to provide their views on these alternatives, or propose others, for us to consider.

¹³ Clause 12(4)(e).

¹⁴ Clause 12(10) of the pricing order.

¹⁵ Essential Services Commission, Victorian Default Offer 2023–24: Final Decision Paper, p. 48, 25 May 2023.

¹⁶ Essential Services Commission, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, p. 77, 3 May 2019.

Victorian Default Offer pricing order

An expert independent chair has provided recommendations to the Victorian Government on possible changes to the Victorian Default Offer pricing order.¹⁷ If changes are made to the pricing order during our review we will give them appropriate consideration in consultation with stakeholders.

How to provide submissions

We invite stakeholders to make submissions in response to this request for comment paper by 5pm 14 December 2023.

We may not be able to consider suggestions made in submissions received after this date.

Visit Engage Victoria's website to make your submission: www.engage.vic.gov.au.

If the deadline for making submissions, or method for making a submission, presents an issue, please email us at VDO@esc.vic.gov.au to discuss other options.

Sensitive or confidential information

Submissions will be made available on our website, except for any information that is commercially sensitive or confidential. Submissions should clearly identify which information is sensitive or confidential.

¹⁷ Review of the Victorian Default Offer Order in Council – Final Report, October 2022.