11 April 2025

Victorian Default Offer 2025-26: Draft Decision Paper
Essential Services Commission
Level 8/570 Bourke Street
Melbourne, VIC 3000

Via: email vdo@esc.vic.gov.au

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

I refer to your 2025-26 Victorian Default Offer: Request for Comment and thank the Essential Services Commission (ESC) for its consideration of stakeholder views.

1st Energy is a non-integrated, second-tier electricity and gas retailer serving customers across New South Wales, Queensland, South Australia, Tasmania, and Victoria. Since our establishment in 2015, we have been committed to offering competitive energy products in an increasingly complex and evolving market.

We appreciate the opportunity to provide feedback on the ESC's draft decision for the 2025-26 Victorian Default Offer (VDO). While the ESC has stated that its approach remains largely consistent with the 2024-25 VDO we believe that key changes – particularly to wholesale cost components and the exclusion of solar exports – do not accurately reflect the real costs incurred by retailers. Solar exports continue to impact wholesale market dynamics, network operations, and hedging strategies, meaning retailers bear costs that are now unaccounted for in the VDO.

Additionally, the reduction of retail operating cost allowances, driven by cost-of-living considerations, raise concerns about whether this is the appropriate mechanism to address affordability while maintaining a sustainable retail market. As such we urge the ESC to reconsider these elements to ensure the VDO reflects the true cost of supplying electricity to Victorian consumers.

Further details on our position in response to the ESC's draft determination can be found in **Appendix A**.

For any queries regarding this response, please contact Aneta Graham, Head of Regulatory and Compliance, [redacted]

Yours sincerely

[redacted]

Liam Foden
Managing Director
1st Energy Pty Ltd

Appendix A

Network

We are supportive of the continuation of a cost pass through approach for approved network costs in the final determination.

Wholesale

The ESC's shift to a five-minute load profile based solely on customer import data represents a significant methodological change from the previous approach, which accounted for the net balance of imports and exports over 30-minute intervals. While we support the move to a more granular five-minute profile, we disagree with the exclusion of solar exports.

As we previously highlighted, solar PV output significantly alters consumption patterns, reducing net customer load during the day and pushing negative spot prices. This is resulting in peakier load profiles, and also in spot price exposure to retailers because when net load and spot prices are negative, we're exposed to spot price outcomes and must make payments to AEMO. Removing exports from the load profile does not reflect the true cost structure faced by retailers.

We acknowledge that the ESC has accounted for the social cost of carbon in the VDO. However, we do not agree that the social cost of carbon offsets the wholesale electricity cost of imports. While the Frontier Economics advice presents market examples based on a balanced position for each interval, we do not agree that retailers can recover wholesale electricity costs for exports through the feed-in tariff.

Retail operating margin

The retail operating margin plays a crucial role in maintaining a competitive and sustainable electricity market. While the draft decision to reduce the margin to 5% is within the expected returns range, it sits at the lower end and places additional pressure on retailers. Median market offers being priced below the Victorian Default Offer (VDO) reflect competitive dynamics, but they do not necessarily indicate that retail margins are excessive—rather, they highlight short-term pricing strategies that may not always be sustainable.

Additionally, we seek further clarity on the specific data and methodology the ESC has used to monitor market offer prices and analyse bills paid. Specifically, we would like to understand whether the ESC is tracking the same retailers consistently for their offers and customer bills to draw these conclusions.

While financial pressures on consumers are a significant concern, addressing affordability by reducing the retail operating margin—one of the smallest cost components of an electricity bill—raises questions about fairness and effectiveness. Other cost components, such as wholesale and network charges, make up a much larger proportion of the total bill, yet retailers are being asked to absorb the reduction. The decision to lower the retail margin rather than addressing other, more substantial cost drivers does not seem to be an equitable approach to managing affordability challenges.

The justification for reducing the margin references financial hardship among customers, but mechanisms such as government hardship programs, targeted rebates, or direct financial assistance are more appropriate ways to address these issues. Retailers already play a role in supporting vulnerable customers through hardship policies, but shifting more of this burden onto them through margin compression could have unintended consequences, including reduced market participation or less competitive pricing over time.

A sustained reduction in retail margins could discourage competition by making it harder for smaller or new entrants to operate sustainably. Over time, this could lead to market consolidation, reducing choice for consumers and potentially leading to higher prices in the long run. If the intent is to maintain a competitive and dynamic retail market, margin reductions should be considered carefully in the broader context of market sustainability.

Environmental costs

The ESC states that their methodology for estimating VEEC costs is comparable to actual prices paid by retailers. However, real market experience suggests otherwise. For instance, while the ESC advised a trade-weighted price of around $102 per VEEC, actual market data shows that retailers have consistently faced higher costs, with prices sitting around $108 from August 2024. This raises the question of where the ESC is sourcing its price data and whether it fully captures the market conditions faced by retailers.

While using a 12-month weighted trading average spot price is a reasonable starting point, it does not fully account for procurement realities. Retailers must secure certificates in a way that aligns with compliance obligations, risk management strategies, and liquidity constraints. This often means relying on forward contracts or structured procurement strategies, which may not align precisely with the ESC's assumed cost methodology. The misalignment between when spot prices are observed and when retailers are required to purchase certificates can introduce cost volatility that is not reflected in the ESC's estimates.

The ESC claims that their estimated price for 2023-24 was $87 per certificate, compared to an average retailer-reported cost of $85. While this appears to be close, the current VEEC market trends suggest a growing discrepancy between modelled costs and actual procurement costs. If retailers are consistently unable to procure certificates at the ESC's estimated price, it indicates a potential flaw in the methodology that needs to be addressed.