Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC 3000

11 April 2025

To Commissioners,

Victorian Default Offer 2025-26 – draft decision

ENGIE Australia & New Zealand (ENGIE) welcomes the opportunity to respond to the Essential Services Commission (the Commission) on the 2025-26 Victorian Default Offer (VDO) draft decision paper.

The ENGIE Group is a global energy operator in the businesses of electricity, natural gas, and energy services. In Australia, ENGIE operates an asset fleet that includes renewables, gas-powered generation, and battery energy storage systems. ENGIE also provides electricity and gas to retail customers across Victoria, South Australia, New South Wales, Queensland, and Western Australia.

ENGIE has largely supported the methodology applied in previous iterations of the VDO, which has provided a relatively stable and predictable regulatory framework for both market participants and consumers. ENGIE is concerned that the proposed changes to the 2025–26 VDO methodology represent a departure from this stability without sufficient evidence to justify these changes.

ENGIE is chiefly concerned with adjustments that include a further reduction in retail margins, as well as the removal of customer exports from wholesale cost methodology. These changes constrain key components of the VDO cost stack that directly impact retailers and risk undermining competition, discouraging innovation, which may ultimately deliver negative long-term outcomes for Victorian consumers.

In this submission, ENGIE has focused its comments on aspects of the methodology that require clarification, further review, or necessary adjustments to ensure that the VDO represents a reasonably priced electricity offer while reflecting the efficient costs of the sale of electricity by a prudent retailer.

Wholesale electricity costs

Excluding customer exports from the load profile oversimplifies the wholesale market risks retailers manage

ENGIE does not support the Commission's draft decision to remove customer exports from the methodology for estimating load profiles. Excluding customer exports understates the contract costs retailers face when purchasing to hedge their net load effectively, which is especially important given that market settlements are determined based on the net balance of imports and exports for each interval. As such, ENGIE contends that this methodology change risks underestimating the financial risks retailers take on to shield customers from the volatility of the wholesale market and urges the Commission to account for both imports and exports in the load profile.

ENGIE notes that the draft decision to adopt a load-only profile is partly based on the assumption that, in the Commission's view, retailers should recover the wholesale costs of customer exports through Victoria's feed-in tariff. ENGIE notes that this assumption does not adequately consider whether retailers can, in practice, recover these costs under the current regulatory framework. For example, in Victoria, the mandated feed-in tariff is now effectively set at zero, which curtails a retailer's ability to recover wholesale export costs effectively.

ENGIE contends that if the Commission intends for retailers to rely on feed-in tariffs for this cost recovery, it must first provide clear evidence that an effective and appropriate mechanism exists to support fair cost recovery. In the absence of such evidence, this methodological change risks misrepresenting the actual costs retailers incur to hedge wholesale exposure from customer exports.

Retail operating costs

Separating customer profiles to calculate retail operating costs demonstrates substantive value to improve the accuracy of the VDO

As outlined in ENGIE's submission on the request for comments paper, ENGIE supported the Commission estimating retail operating costs separately for residential and small business customers. This was on the condition that separate profiles demonstrated substantive value to improve the accuracy of the methodology without creating a sense of false precision.

ENGIE notes that the Commission's analysis in the draft decision illustrates that the previous uniform benchmark likely underestimated the costs of serving small business customers. Given this finding, ENGIE does not support the Commission's decision to continue using a uniform benchmark. While ENGIE acknowledges that the Commission seeks to construct a reasonably priced electricity option through the VDO, ENGIE considers that accuracy and transparency are equally important in the calculation of retail operating costs to uphold the credibility of the underlying methodology. As such, the adoption of separate customer profiles would be a welcome evidence-based improvement to uplift the overall accuracy of the VDO.

Using customer-weighted averages to calculate retail operating costs disadvantages smaller retailers

ENGIE continues to advocate for a methodology change to replace the use of customer-weighted averages with another statistical method, such as the median value, to calculate retailer costs. As noted in ENGIE's previous submission, the use of the customer-weighted average approach skews the costs incurred by retailers towards those with significantly larger customer bases. As a pragmatic next step, ENGIE contends that the Commission should conduct more robust statistical testing and provide transparent reasoning to support the continued use of customer-weighted averages in lieu of a more appropriate statistical method.

Retail operating margin

The justification for reducing the retail margin to five per cent is unclear

ENGIE does not support the Commission's decision to reduce the retail operating margin from 5.3 per cent to five per cent for the 2025–26 VDO. ENGIE contends the rationale underpinning this reduction lacks transparency and is based on limited evidence, particularly when viewed alongside a broader trend of constraining retail margins across previous VDO determinations.

One example of limited evidence is the Commission's assertion that many market offers listed on the Victorian Energy Compare website are priced below the VDO, implying that the current VDO is not below the efficient cost to serve. This logic is inherently flawed. While it is true that many offers are below the VDO, these offers are far more likely to be a symptom of the competitive pricing strategies retailers employ to attract new customers rather than a reasonable or long-term efficient price to retail electricity.

ENGIE also notes that the Commission has sought to justify its draft decision to reduce the retail operating margin by referencing historically calculated margins and reported retailer earnings. This approach fails to account for the market disruptions that have materially constrained retailer margins in recent years, including the volatility in wholesale prices. As such, ENGIE contends that relying on these historically suppressed margins as a benchmark for determining a sufficient operating margin is fraught with incomplete assumptions, as it assumes these levels are adequate to enable retailers to recover appropriate revenue, invest in innovation, and compete effectively.

A margin of at least 5.7 per cent aligns with standards upheld in previous reviews conducted by the Commission

ENGIE encourages the Commission to reinstate the retail operating margin to a minimum of 5.7 per cent for the 2025–26 VDO, which is within the range outlined by the Commission's consultant Frontier Economics. Following this reinstatement, ENGIE supports maintaining the 5.7 per cent margin for an extended period, such as three years, to provide regulatory certainty for market participants. In light of the limited evidence used to justify the reduction of retail margins, ENGIE also urges the Commission to conduct an evidence-based review to examine the trend in margins, active retailers, the distribution of market share and the overall health of the retail market.

Environmental costs

Victorian Energy Efficiency Certificates (VEEC) prices continue to increase amidst liquidity and certificate creation issues

ENGIE continues to contend that the Commission's current methodology for estimating the cost of the Victorian Energy Upgrades (VEU) program does not adequately reflect the rising cost of VEECs. The current reliance on a twelve-month historical average price fails to capture relevant market dynamics, where the spot price is unlikely to decline in the near term. This is due to the saturation of lower-cost activities, such as LED lighting upgrades, and the growing reliance on higher-cost electrification activities to meet scheme targets.

ENGIE also notes that there are potential scenarios where the Commission's current methodology would underestimate the costs retailers face to deliver the VEU program. For example, retailers may face non-delivery of VEECs due to factors outside their control, such as supply disruptions, which may require them to purchase certificates on the spot market at prices above the Commission's calculated 12-month average. This exposes retailers to heightened cost volatility not captured under the current approach.

As such, ENGIE continues to maintain that a preferable methodology change would be to consider using the most recent six months of historical spot market prices prior to the final VDO determination. This approach would better reflect the most current market conditions to more accurately estimate VEEC-related costs.

Concluding remarks

ENGIE looks forward to working closely with the Commission to ensure that the 2025-26 VDO represents a reasonably priced electricity offer while reflecting the efficient costs of the sale of electricity by a prudent retailer.

Should you have any queries in relation to this submission, please do not hesitate to contact me by telephone, on [redacted].

Yours sincerely,

[redacted]

Ronan Cotter
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