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LIGHT THE WAY

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Essential Services Commission
Victorian Default Offer Draft Decision
By email**: VDO@esc.vic.gov.au**

ESC Victorian Default Offer 2025-26 – Draft determination

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts across eastern Australia, of which around 59k customers are supported under our hardship program (EnergyAssist). EnergyAustralia owns, contracts, and operates a diversified energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 5,000MW of generation capacity.

EnergyAustralia welcomes the opportunity to make this submission to the Essential Services Commission Draft Determination for the 2025-26 Victorian Default Offer (VDO). We appreciate the challenges the ESC faces in setting the VDO in the context of cost-of-living pressures, high energy costs, and the impacts of electricity affordability for customers.

Consistency and predictability in regulatory decisions, including the VDO methodology, are essential to help support a competitive environment that drives lower prices and better outcomes for all customers – including those facing financial strain. Overall, while we support the ESC's commitment to maintaining a largely consistent VDO methodology we encourage the ESC to carefully consider the timing impact of the shift to a 'load-only' wholesale profile, alongside the reduction in margin. This is especially important in a market experiencing ongoing cost increases driven by the energy transition, rising network costs, evolving regulatory pressures, and the need to innovate—factors that require significant upfront capital investment and expose retailers to risks and uncertain long-term returns.

We believe that incorporating a transitional adjustment would allow for a smoother shift in the wholesale cost methodology, and a reassessment of the margin is necessary to reflect the heightened risks retailers face, especially in Victoria, which presents unique cost challenges for both retailers and customers. These issues on the wholesale load profile and retailer risk are detailed in our full submission in the **Attachment**.

Further detailed comments on the draft VDO methodology relate to retailer costs. We fully support the ESC's continued data-led approach to determining retailer operating costs, and retailer Cost to Acquire and Retain Customers (CARC). We believe there is an opportunity to improve the transparency of retailer operating costs, and the retailer CARC benchmark, and encourage the ESC to adopt our suggestions in the final VDO decision.

We believe that government energy bill relief measures, combined with the existing hardship policies and customer protection frameworks within the current regulatory structure, are well-positioned to address affordability concerns. These mechanisms offer a more balanced and less disruptive approach compared to further revisions to the VDO methodology, helping support a stable and fair market environment.

In the absence of any additional new issues or significant changes, we have not re-raised points already discussed in previous submissions. We support and continue to encourage the ESC to remain open to changes if new evidence arises that may warrant consideration and revision.

If you have any questions in relation to this submission, please contact me [redacted].

Yours sincerely,
Maria Ducusin
Regulatory Affairs Lead

We support the use of a 'load only' profile but encourage a transitional provision

We appreciate the ESC's effort to align the wholesale load profile with the AER's methodology. While we support the shift to the 'load-only' profile, driven by updated AEMO data, we have concerns about the timing of this shift – particularly given the cost pressures unique to Victoria.

Retailers have made business decisions based on the predictability of regulatory decisions - including the VDO. In our previous VDO submission, we highlighted that uncertainty in price regulation presents financial planning challenges for retailers which can result in outcomes that are difficult to anticipate and/ or adapt to. The recent shift in the VDO wholesale methodology to use a 'load only' profile – while justifiable, presents exactly this type of challenge. This change leads to a shift from a higher wholesale cost provision to a low one, all while the market is experiencing ongoing cost increases due to the energy transition, rising network costs, evolving regulatory pressures and expectations, and now also reduction in the margin. Together, these factors collectively place significant strain on retailers, who are expected to absorb all these risks while remaining competitive and innovative.

A smoother transition is needed - better reflecting risk in the VDO methodology

We encourage the ESC to strike a better balance in the final VDO decision and consider:

- **A transitional adjustment to the rebasing of the wholesale cost**: A more gradual transition, akin to a glidepath, would allow for a smoother shift before the full implementation in the 2026-27 VDO. The adjustment should align the starting point for the new load-only profile methodology with the previous balance-only profile. This would avoid abrupt changes and mitigate unintended consequences from a step change in cost allocations.
- **The appropriateness of the margin reduction**. Given the elevated risks and financial pressures retailers face, including regulatory challenges and expectations to innovate, it is questionable whether a prudent investor would consider the reduced margin to be an adequate return.

A concern with the approach in previous VDO determinations was that retailers bear more risk – not less - in the current high-cost environment. This includes shouldering the risk from rising network costs, a trend likely to continue with the energy transition. We questioned whether retailers could absorb all this risk, invest in innovative Consumer Energy Resource Products, and continue to compete in this challenging environment.

As we move into the 2025-26 VDO Final decision we continue to have these concerns and call the ESC to reconsider the appropriate balance in setting the VDO to reflect better reflect retailer risk and have suggested ways to do this above.

The ESC's VDO Draft Determination states:[1]

> *We note the comments from retailers on growing risks associated with the energy transition, however, we consider that those risks are already, or can be, diversified through using financial instruments, hedging strategies, technological innovation, and long-term hedging contracts. We note that wholesale market risks are accounted for in the wholesale cost component of the cost stack. We consider that innovation costs and risks associated with consumer energy resources are accounted for in our approach to using a benchmark of actual retailer operating costs for that component of the cost stack.*

While we appreciate the ESC has noted the concerns associated with retailer risk and the energy transition, we consider this growing risk should not be overlooked and highlight two concerns:

1. **Hedging and its limitations**. While hedging can mitigate short-term price volatility, it does not address the broader structural and operational risks of investing in Customer Energy Resources (CER). These risks go beyond market price fluctuations and involve substantial investment in new technologies such as storage solutions and demand response, which carry long-term uncertainties and require significant upfront capital.
2. **Innovation costs are not covered by Retailer Operating Costs benchmark.** Innovation costs, which include testing and piloting new products like demand response or Virtual Power Plants and investing in new technologies such as battery storage solutions, are not reflected in the benchmark for operating costs. These costs are distinct from operating costs and are critical to ensuring retailers can meet the challenges of a changing energy landscape.

[1] ESC, *Victorian Default offer 2025-26 Draft Decision paper*, p 57.

Both these issues underscore the importance of ensuring adequate provision within the VDO methodology to support retailers in managing these risks and making the necessary investments to drive the future of Victoria's energy system.

Enabling innovation today is critical for retailers to drive tomorrow's transition

CER is a critical component of the energy transition and supports electrification in Victoria. As Victoria moves towards greater electrification, retailers play an increasingly vital role in managing the complexities of this shift. Recent political announcements, such as the expansion of the Small-Scale Renewable Energy Scheme (SRES) to include batteries, highlight the growing responsibility of retailers to support customers in adopting battery systems at scale.[2]

Subsidies and incentives encourage customers to invest in batteries and retailers are essential to the broader transition. Policies promoting battery adoption require retailers to manage a larger customer base with storage systems and integrate customers into virtual power plants (VPPs). Retailers must also navigate complex regulatory challenges that continue to change, including billing and communication requirements with customers. All these measures require large investment and innovation.

There is a delicate balance between addressing short-term affordability and ensuring long-term sustainability. We believe government energy bill relief measures, alongside existing hardship policies and customer protection frameworks, are the most effective mechanisms to address affordability concerns—rather than further revising the VDO methodology.

To meet Victoria's climate targets and build a resilient energy system, retailers must be able to invest and innovate today. However, the cost pressures they face, combined with regulatory demands, cannot be overlooked. Without adequate support within the VDO methodology—the ability to keep up with electrification and innovation is at risk.

Victoria presents unique cost challenges which impact retailers and customers

Victoria poses particular cost challenges for retailers, especially due to the mandated Feed-in Tariff (FiT) framework. Retailers are required to offer a minimum flat rate of 0.04 c/kWh for solar exports, even though the true market value of solar exports is often negative. These challenges are exacerbated by the fact that Victoria experiences more negative price

[2] Joint Media Release, Prime Minister of Australia and Minister for Climate Change and Energy, *Labor to Deliver One Million Energy Bill Busting Batteries*, 6 April 2025.

events compared to other states, such as NSW, where there is no mandated FiT. For example, see Figure 4.6 below which compares Victoria and NSW - noting that NSW, covered by the DMO, does not have a mandated minimum FiT.

This above makes it even more difficult for Victorian retailers to absorb the increasing operational and innovation costs that are integral to the transition.

Figure 4.6 Percent of daytime (8 am to 4 pm) wholesale prices that were negative each month, NSW and Victoria.

Note: This graph shows how many half-hour daytime price blocks (between 8 am and 4 pm) are negative each month in NSW and Victoria. From 2021, AEMO prices operated in 5-minute intervals. Before this, prices were in 30-minute blocks. We have combined all 5-minute interval data into 30-minute intervals so we can compare prices from before and after 2021.

Source: IPART analysis of AEMO wholesale price data for Victoria and NSW.

Regulators and Governments have an important role in raising awareness of solar export pricing

As the economy transitions away from fossil fuel, the number of rooftop solar installations has reached unprecedented levels. While this shift is critical for achieving our Victorian climate targets and a sustainable energy future, it has also led to a decrease in the market value of solar exports. With an oversupply of solar generation, negative pricing is becoming more common as the energy grid cannot absorb the surplus power, leading to situations where the price of electricity falls below zero.

We agree with the ESC's approach in accounting for the social cost of carbon in the 2025–26 VDO,[3] and recognise that this helps offset the wholesale electricity cost of solar exports.

[3] ESC, *Victorian Default offer 2025-26 Draft Decision paper*, p 27.

However, we also highlight the growing need for regulators and governments to raise awareness among customers about these changes. We encourage the ESC to continue to educate customers about the changing value of solar exports - particularly the continuing prevalence of negative pricing from surplus solar power in the grid and the impact this has on solar export pricing.

Current market dynamics mean retailers are already facing situations where the market value of solar exports may be insufficient to recover costs associated with paying for the excess power when prices are negative, as well as any additional network charges associated with this surplus generation. This underscores the importance of ensuring sufficient provision in the VDO methodology to help retailers manage these market challenges and recover costs - particularly in Victoria where there is a mandated minimum FiT.

We suggest additional transparency measures on the Retail Operating Cost

We fully support the ESC's continued data-led approach to determining retailer operating costs, as it ensures that decisions are based on real and relevant data, which is essential for ensuring fair and accurate VDO outcomes. In this regard, we encourage the ESC to explore expanding the retailer dataset to cover 99% of retailers, as is done in the DMO approach. This would help capture a more comprehensive range of cost structures, further strengthening the robustness of the ESC's methodology and decision-making process.

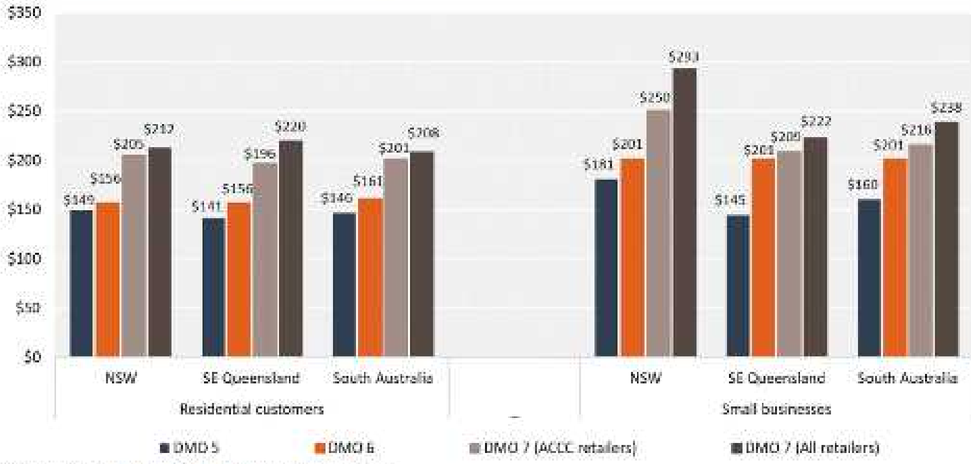
We are unable to reconcile the difference between Victorian retail operating costs and those in non-Victorian states, despite both VDO and DMO using similar methodologies (i.e., customer-weighted average using actual retailer operating costs). We believe that further exploration and transparency is needed to understand the underlying reasons for this difference.

While we understand that the ESC sets a retail operating cost benchmark based on what it considers are the costs faced by an efficient retailer,[4] we may not have full visibility into what retail operating costs are being captured by the retailer data but excluded by the ESC for the calculation of this benchmark (if any), or the rationale behind why certain costs may not be included. We encourage the ESC to provide further clarity on this in the final VDO decision to enhance transparency and help retailers better understand the benchmark calculation.

[4] ESC, *Victorian Default offer 2025-26 Draft Decision paper*, p 38.

As shown in the AER's analysis from DMO 4 to DMO 7 (see Figure 7.1 below), there has been a noticeable increase in retail and other costs, reflecting growing pressures on retailers, particularly larger ones who are absorbing higher hardship and debt collection costs. These pressures have become more significant due to the growing number of customers experiencing hardship and evolving regulatory requirements. The rising costs underscore the challenging cost environment in which retailers are operating.

Figure 7.1 Time series of weighted average retail and other costs ($/customer) by DMO region and customer type, including GST



Source: AER analysis of retail cost information.

To further enhance transparency, we suggest that the ESC consider publishing interquartile range (IQR) charts of retailer operating costs, like those published by the AER (see Figures 7.3 and 7.5 in **Appendices A and B**). These charts would provide a clearer view of the spread of retailer operating costs, offering a better understanding of cost variability within the market.

We believe that publishing these IQR charts would improve transparency in regulatory decision-making and also reinforce the ESC's commitment to a data-driven, evidence-based approach. Following the AER's lead would further strengthen industry best practice and support consistency across regulatory bodies.

The benchmark for CARC is over 10 years old and risks misrepresenting costs

We fully support the ESC's data-driven approach in determining the Cost to Acquire and Retail Costs (CARC), but we believe that the reliance on the 2013-14 ACCC CARC data adjusted for CPI appears outdated and will not reflect current market conditions. While consistency in methodology is valuable, the energy market has changed significantly over the past decade. Technological advancements, the rise of renewables, shifts in customer behaviour, and evolving regulatory pressures are not captured by CPI adjustments. Continuing to use this dated benchmark risks understating the costs retailers face today.

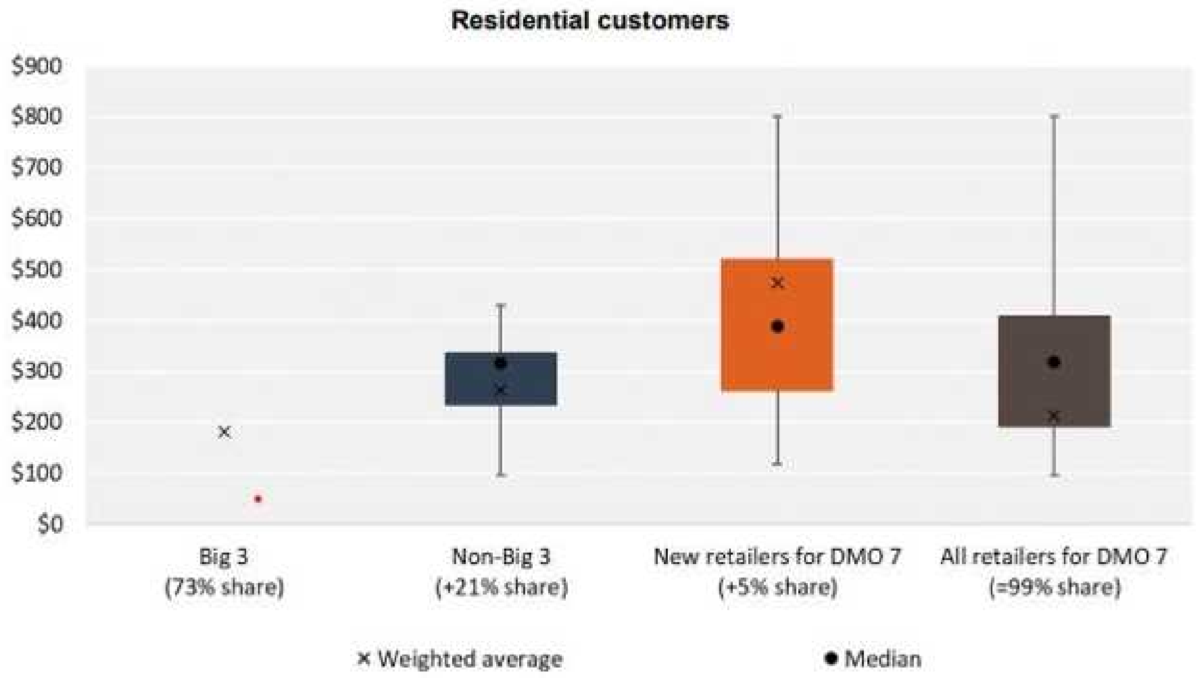
We understand the ESC must ensure the CARC provision is "modest" under the VDO pricing order.[5] What is considered a “modest” provision today is different from what was deemed “modest” 10 years ago, given the significant changes in the market. We encourage the ESC to provide further clarity on what “modest” means – particularly in the context of a high-cost, highly competitive, evolving and complex retail environment.

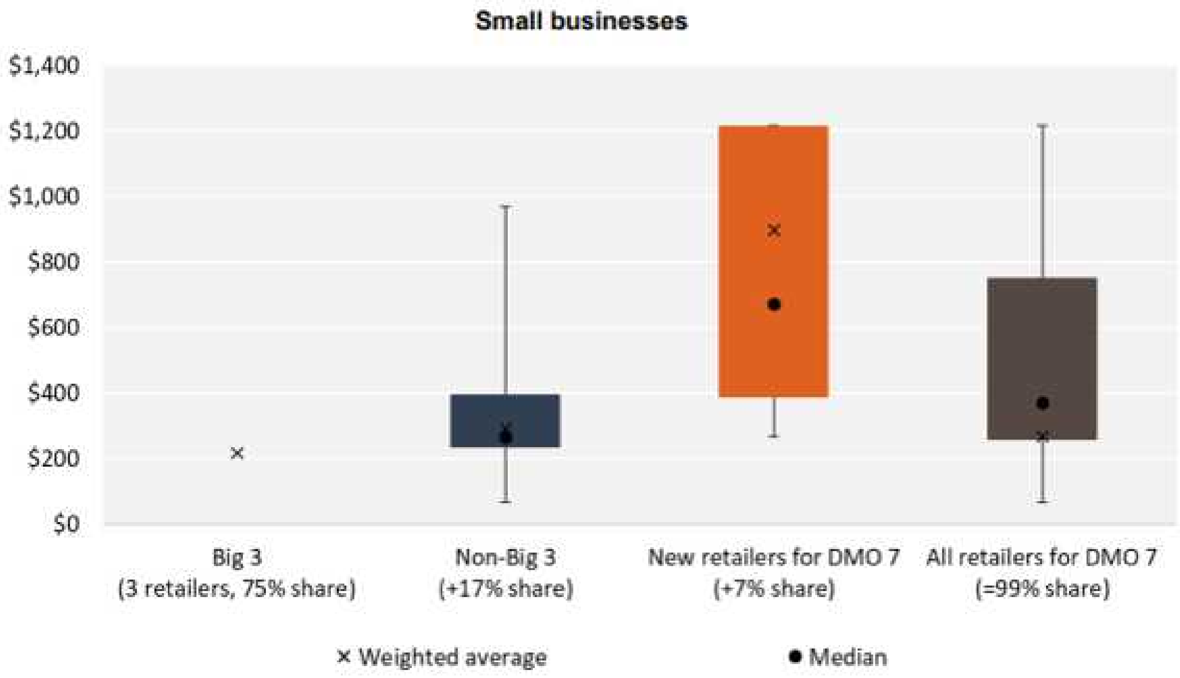
[5] Clause 12(4)(d) and Clause 12(6) of the pricing order

Appendix

Appendix A

Figure 7.3 Distribution of retail and other costs ($/customer), by customer type, all DMO regions, including GST

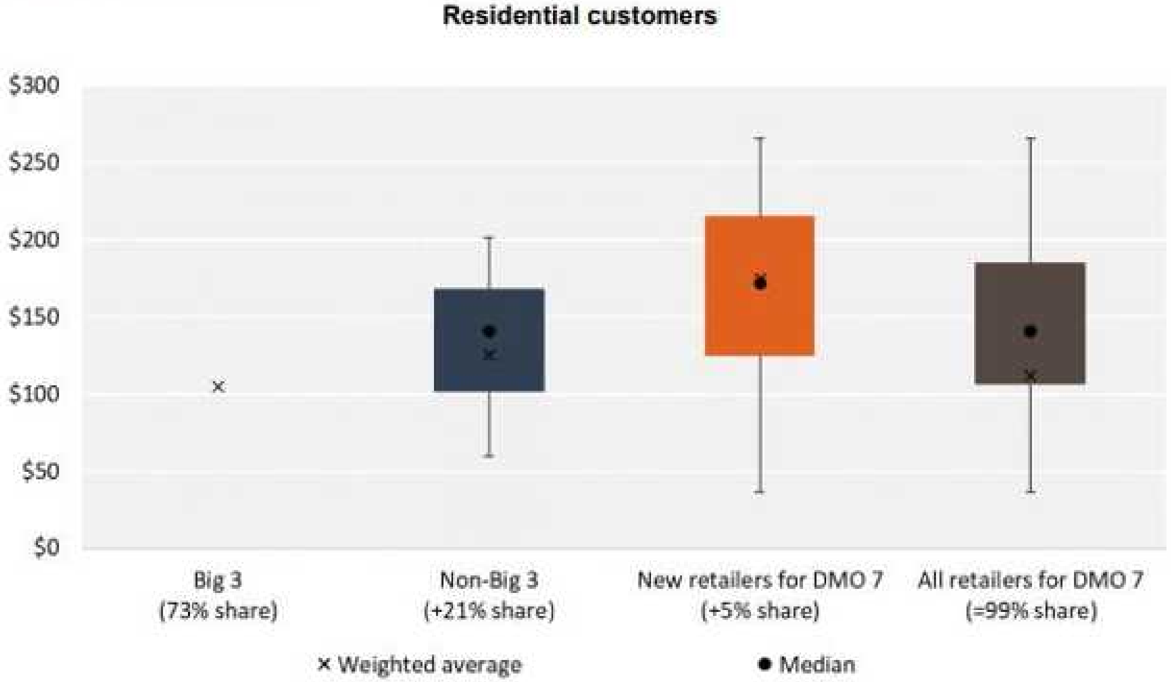


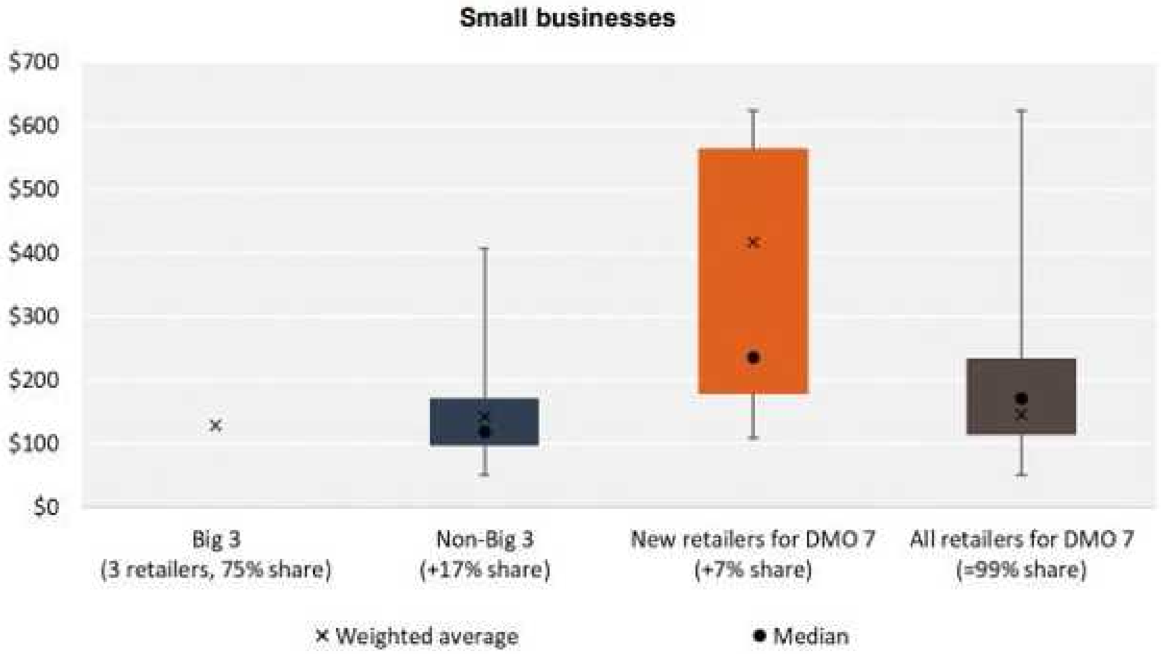


Source: AER analysis of retail cost information. Note that 2 retailers are excluded from this chart for residential customers due to high retail and other costs. Similarly, 2 other retailers are excluded from this chart for small businesses. However, their data was included in the weighted average calculations.

Appendix B

Figure 7.5 Distribution of costs to serve ($/customer), by customer type, all DMO regions, including GST





Source: AER analysis of retail cost information. Note that 2 retailers are excluded from this chart for residential customers due to high retail and other costs. Similarly, 2 other retailers are excluded from this chart for small businesses. However, their data was included in the weighted average calculations.