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

ESC Victorian Default Offer prices 2025-26 Comment paper – PUBLIC VERSION

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts across eastern Australia. We also own, operate and contract 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 provide this submission to the Essential Services Commission's (ESC) request for Comment Paper on the Victorian Default Offer (VDO) 2025-26. We appreciate the ESC's commitment to maintaining consistent methodologies, which supports regulatory predictability and enables retailers to plan effectively and make efficient decisions. We address key topics in the VDO comment paper in turn.

Retail operating cost – separating cost for residential and small business customers

We do not have a strong preference on whether retail operating costs should be separated for domestic and small business customers but recognise the ESC's intent to reflect potential cost differences in serving these customer segments. The change in methodology could see a small reduction in retail operating costs for residential customers offset by a large increase in costs for small business customers. Should the ESC consider changing its approach, we encourage careful evaluation of whether:

- the potential benefits of separating costs outweigh the risk of disproportionately burdening small businesses, who tend to face higher average bills and
- any additional complexity does not impose administrative or compliance burdens on smaller retailers.

Should the ESC decide to separate retail operating costs, it is vital that the **weighted average cost figure remains the same overall**. This ensures that the total retail operating cost pool does not shift, avoiding unintended cost changes between customer types. Consistency in approach ensures comparability across decision cycles. Further, it will be necessary to **rebase the current FY25 VDO** to reflect the delta between domestic and small-business retail operating costs. This would involve recutting the FY25 VDO retail operating cost into separate residential and small business components to ensure an "apples-to-apples" comparison with any future estimates. This transparency is essential to understand how separating costs affects the overall allocation between residential and small-business customers.

Estimating Victorian Energy Efficiency Certificates (VEECs)

We support consistency and the ESC's approach using spot prices for VEEC, which uses the **12-month trade-weighted average spot price** to estimate VEEC costs.

We urge caution regarding any changes to the methodology that would mix forward and spot prices, as referenced in the paper.[1] Non-delivery risks inherent in forward contracts highlight the challenges and potential pitfalls of relying on a mixed approach. Specifically:

- **Non-delivery risks**: Retailers who purchase VEECs through forward contracts but fail to receive them are exposed to significantly higher spot prices. In 2023 and 2024, several major forward contract providers, including LEEA Investment**,** Emerging Energy, and OZ Wide Energy**,** failed to deliver on their commitments. This left retailers with no alternative but to purchase certificates on the spot market, often at prices significantly higher than the original forward contract rates. [**Confidential**: [redacted])].
- **Market structural issues**: structural challenges in the VEEC market, such as limited liquidity and unreliable forward counterparties, mean that retailers cannot always control this risk.

Wholesale cost – load profile and solar exports

Solar exports add volatility, especially during negative pricing events, which increases the cost of managing risk. We consider this should continue to be accounted for in the VDO price setting and the ESC maintain its approach to netting off solar in the load profile. While provision can be made to account for these costs in other aspects of the VDO (e.g. retail operating margin), one could argue that the simpler and cleaner approach would be to reflect this in the load profile itself. Maintaining the ESC's approach reflects hedging practices - focusing on market-based exposures.

[CONFIDENTIAL: [redacted]

[1] ESC, *2025-26 Victorian Default Offer - Request for comment paper - November 2024*, p 10.

[redacted].]

Retail operating margin – reflecting retailer risk

The recent reduction of the margin from 5.7% to 5.3% appears to assume that retailer risks have decreased. However, we believe this assumption does not align with the current operating environment. Retailer risks appear to have increased, as demonstrated by the following examples:

- **Escalating non-delivery risks in forward contracts**, as seen with counterparty failures noted above.
- **Structural challenges in VEEC markets** leading to greater volatility and exposure to unpredictable costs.
- **Heightened regulatory enforcement** risks across the energy market. Regulatory scrutiny has intensified, increasing compliance obligations and costs for all retailers, regardless of their efficiency.
- **Retailers bearing the risk of rising network costs** - risks likely to grow as the energy transition progresses.
- **Pressure to mute network price signals**: Retailers face growing pressure to address customer concerns about network tariff changes, such as time-of-use (TOU) and demand tariffs, by offering flat tariffs that do not reflect the underlying network cost structure. This approach obscures price signals intended to encourage efficient energy use, reducing the effectiveness of cost-reflective tariffs and shifting additional financial risks onto retailers.
- **Uncertainty in price regulation** which present financial planning challenges for retailers which can result in outcomes that are difficult to anticipate and adapt to.
- **Innovation risks in Consumer Energy Resource (CER) Products.** Retailers are increasingly engaging with innovative CER products, such as demand response, battery storage, and dynamic tariffs, which carry higher short-term risks but deliver significant long-term benefits (e.g., improved grid efficiency and reduced customer costs). However, the ESC's focus on minimising short-term costs in VDO price settings may inadvertently discourage such investments, stifling innovation and undermining dynamic efficiency.

These challenges demonstrate that retailer risks have not decreased but appear to have escalated. In light of these factors, the current retail operating margin of 5.3% likely represents the lower end of the acceptable range identified by Frontier Economics (4.8% to 6.1%). While it may appear near the midpoint, we question whether there were compelling reasons to revise this downward given growing retailer risks.

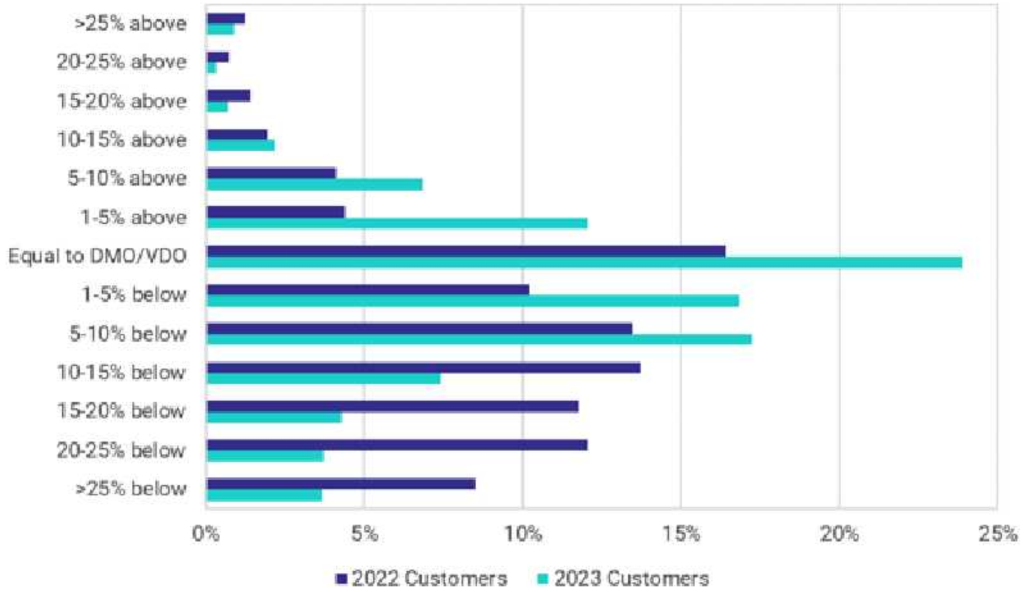
Further, the ESC's use of ICRC benchmarking from the ACT, while informative, may not adequately reflect the higher risks and complexity of the Victorian retail market. Unlike the ACT, Victoria faces unique structural challenges, such as volatility and compliance risks in VEEC markets and the added pressures of supporting innovative Customer Energy Resource (CER) products during the energy transition. These factors, combined with higher regulatory scrutiny, suggest that the risks faced by Victorian retailers are materially greater and should be accounted for in the retail operating margin.

Challenging retail market conditions

The ESC has noted that actual margins have decreased since 2019. However, this trend does not reflect reduced risks for retailers but rather the increased pressure on margins due to rising operational and systemic costs. The ESC should avoid assuming that lower actual margins are an indicator of efficiency gains when they may instead reflect unsustainable price pressures.

Market offers clustering around the DMO/VDO price in recent years seem to indicate that offering lower rates below DMO/VDO prices is challenging for retailers to sustain. This clustering - along with the reduction in discounts in offers and increased offers above the DMO/VDO suggest that retailers are finding it challenging to offer significantly lower rates. Ongoing adjustments to the VDO framework may be necessary to ensure sustainability.

Figure 3.2 in ACCC report: Proportion of residential customers on flat rate plans paying more, equal to, or less than the DMO/VDO assuming 100% achievement of conditional discounts:[2]



Source: ACCC analysis of retailers' data.

Over time, persistent price compression may narrow retail market dynamics and:

- reduce incentives for CER innovation and customer engagement.
- limit diversity in retail offerings, diminishing customer choice.
- create risks of market exits, especially for smaller or new entrants unable to sustain operations within compressed margins.

2 This appears to be from the most recent ACCC report with this analysis, with another report expected December 2024 or January 2025. ACCC, *Inquiry into the National Electricity Market: December 2023 Report*, p47.

Long-term implications for retail market competition should be considered

The VDO price setting should ensure that retailers can absorb rising risks and continue to provide reliable service. As highlighted in our recent submission to the AER on the Default Market Offer ensuring an adequate retail margin supports ongoing investment and resilience in the sector.

In assessing retailer risk and the retail operating margin, we encourage the ESC to consider insights from its Victorian Energy Market Report for understanding retail market dynamics. According to most recent Victorian Energy Market reports, three electricity retail licences were granted in 2023–24 and three were also revoked by agreement with the licensees. Notably:

- **New Licences Granted:** Tesla Energy Ventures Australia Pty Ltd, Flo Energy Australia Pty Ltd, and CEP Energy Retail Pty Ltd.
- **Licences Revoked:** WINconnect Pty Ltd, QEnergy Limited, and Mojo Power East Pty Ltd in 2023–24. Additionally, five licences were revoked in 2022–23, including Elysian Energy Pty Ltd and Powerdirect Pty Ltd.

Key questions for the ESC to consider when assessing long-term retail market dynamics:

- What kinds of retailers are making certain offers?
- What kind of retailer is entering the retail market?
- What kind of retailer has exited the retail market?
- Does this represent the mix of participants that the ESC wants to see for effective retail competition that will benefit consumers over the longer term and during the energy system transition?

The retail operating margin must reflect the real risks faced by retailers, which have not decreased but appear to have escalated due to regulatory, market, and structural challenges. Maintaining or modestly increasing the margin would better account for these risks, supporting retailer sustainability and market competition over the long term. We encourage the ESC to adopt a holistic view of retailer risk and market dynamics to safeguard the resilience and sustainability of the retail energy sector.

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

Yours sincerely,
Maria Ducusin
Regulatory Affairs Lead