

Mr. Gerard Brody
Chairperson
Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC 300

Lodged via online portal

10 April 2026

Dear Mr Brody

Subject: Submission to the Victorian Default Offer 2026–27 Draft Decision

1. Introduction

The Australian Energy Council (**AEC**) welcomes the opportunity to provide this submission to the Essential Services Commission (**ESC**) in response to the *Victorian Default Offer 2026–27 Draft Decision*. The AEC’s comments focus on the specific areas identified for consultation, including wholesale electricity costs, network tariff structures, free power period tariffs, and other cost components, while also raising a small number of broader issues relevant to the operation of the framework as a whole.

The AEC is the peak industry body for retailers and generators operating in energy markets. Our members generate and sell energy to over 10 million homes and businesses. We seek to deliver a market that allows consumers to benefit from the transition to a reliable, affordable and decarbonised energy system. The AEC supports the transition to net zero emissions by 2050, and the role of the electricity sector in unlocking opportunities for reductions in other sectors. AEC members are major investors in the renewable energy, firming and energy security services needed to deliver an effective transition.

The AEC understands the policy intent of the VDO as a safeguard for customers who are unable or unwilling to engage in the retail market. It also serves as a reference price for discounted market offers. Given the VDO’s dual role as both a regulated standing offer and a widely used reference price, it is critical that the methodology continues to reflect efficient retailer costs, supports competition and avoids unintended distortions.

The 2026-27 draft decision presents a relatively stable cost stack with a modest reduction in headline bills (subject to any implications of the global energy crisis for the final cost calculations). However, we wish to draw your attention to salient issues for retailers for the ESC’s consideration prior to the final decision.

2. The role of the VDO and the importance of cost-reflectivity

The ESC has emphasised that the VDO must reflect the efficient costs of supplying electricity while promoting the long-term interests of consumers.

In responding to the ESC’s proposed approach across the cost stack, the AEC considers that three design principles remain particularly important:

- the VDO should reflect the full and unavoidable costs faced by an efficient retailer;

- efficient cost estimation should account appropriately for risk – while there is a modest volatility allowance in the wholesale cost component, retailers face risk elsewhere in their cost structures, too.
- methodological settings should be internally consistent across the cost stack; and
- the framework should support, rather than undermine, retail competition and innovation.

The AEC considers that, while the draft decision broadly maintains consistency with prior years' considerations, it is advisable to assess whether some areas align with those principles, particularly in relation to wholesale cost treatment, tariff structure changes, regulatory timing, and the implementation of the Victorian Government's Midday Power Saver.

3. Interpreting the 2026-27 draft outcome

The ESC's draft decision indicates that average domestic bills will fall by approximately \$46, driven largely by lower environmental costs, with wholesale costs broadly stable and network costs slightly increasing. While this outcome is presented as a reduction in customer bills, it is important to recognise the underlying drivers that:

- environmental costs have reduced;
- network costs continue to rise and remain the largest component; and
- wholesale costs remain subject to uncertainty and modelling assumptions

This creates a situation where the headline reduction is not necessarily indicative of a structurally lower-cost environment. Rather, it reflects movements in specific cost components, some of which are volatile or policy-driven. We consider that this distinction is important when assessing the robustness of the methodology and its implications for future determinations.

4. Network cost pass-through and regulatory timing risk

The AEC supports the continued pass-through of network costs, while noting several implementation considerations. The draft decision relies on 2025-26 network tariffs indexed for inflation, with final 2026–27 tariffs to be incorporated at the final decision stage. As such, this approach introduces a degree of regulatory timing risk, particularly as the draft bill outcomes do not reflect final network cost settings. Additionally, it requires stakeholders to engage with the ESC on the basis of incomplete information and it limits visibility on the impact that network changes have on final outcomes. Given that network costs are the largest component of the VDO cost stack, even modest changes to this can materially affect final prices. The transition to three-period ToU tariffs is appropriate in the light of the importance of maintaining pass-through, but raises practical and timing implementation challenges, given retailers require adequate time to process new tariff codes and update Deemed Best Offer processes. The AEC expects that its members will engage individually with the ESC on any specific compliance challenges they are facing.

4.1 Customer comprehension and engagement

The introduction of a three-period structure increases tariff complexity. While this may improve cost reflectivity, it also introduces risks for customers who have limited ability to shift consumption, do not

actively engage with tariff structures or may not clearly understand the implications of different usage periods. This will be further compounded by the introduction of the Midday Power Saver. Given that the VDO is intended to be a simple and trusted offer, we consider it very important that an appropriate balance is struck between economic efficiency and customer usability. In this domain, the AEC encourages the ESC to support customer understanding and minimise potential confusion during the transition.

4.2 Alignment between network tariffs and retailer systems

We note that a key objective of the reform is to better align retail tariffs with underlying network cost structures. This is appropriate in principle. However, differences in timing, definitions and implementation across distribution network service providers can create increased basis risk, worsen system configuration challenges and result in increased compliance and billing complexity

The AEC considers that continued coordination with network businesses and clear articulation of standardised time bands will be important to ensure the reform achieves its intended outcomes without introducing unnecessary operational burden.

5. Wholesale electricity cost methodology - Load-only profile and export treatment

In response to the ESC's proposed treatment of exports within the wholesale cost component, we note that the continued use of a load-only profile, excluding exports, has important implications for cost recovery and risk allocation. Under the draft decision, no wholesale cost of exports is included because the forecast solar-weighted wholesale price is positive. While this is consistent with the ESC's framework, we consider that this raises a broader question of principle.

Retailers face real and unavoidable costs associated with customer exports, including exposure to negative pricing events, settlement and clearing costs and hedging cost impacts.

A framework that only recognises export costs when net settlement is negative may not fully capture the efficient costs faced by retailers in managing these exposures. The AEC considers that the ESC should continue to test whether the current approach remains consistent with the efficient cost objective, particularly as solar penetration increases and price volatility intensifies.

We note there are interactions between the policy assumptions underpinning the Midday Power Saver and the Commission's treatment of export-related costs. Greater alignment over time would support consistency in price-setting signals.

We further note an inherent contradiction between the assumption underlying the Midday Power Saver – that wholesale costs are on average zero or lower - and the ESC's position on the cost of exports. We recognise that the Midday Power Saver is a government policy rather than a regulatory decision; nonetheless, we think a holistic consistency on regulated price-setting is desirable.

6. Retail operating costs and margin

The draft decision maintains the retail operating margin at 5 per cent and retains the existing benchmarking approach for retail operating costs. The AEC acknowledges the ESC's focus on stability and consistency in these components. However, we consider that there are two areas that warrant further consideration.

First, the retail operating cost benchmark is derived from a customer-weighted dataset with outlier removal and efficiency adjustments. While this approach is reasonable, the limited transparency of the underlying data continues to create challenges for stakeholders in assessing whether the benchmark fully reflects efficient costs. Further, the dataset covers a period from two years before the VDO period, yet the CPI allowance is only one year's worth. As inflation pressures rise again, this risks materially understating efficient costs. The AEC would welcome further engagement with the ESC and stakeholders on this point.

Second, the retail margin remains at the lower end of observed regulatory benchmarks. The ESC has previously emphasised that margins should not compensate for risks addressed elsewhere in the cost stack. However, as noted above, the separation between wholesale risk and broader retailer risk is not always clear-cut. Maintaining a margin at the lower bound of comparable benchmarks, in combination with increasing operational and regulatory complexity, raises questions about whether the framework provides appropriate incentives for continued participation and investment in the retail market.

7. Treatment of “other costs” and emerging obligations

In response to the ESC's proposed treatment of other cost components, including AEMO fees and ancillary service costs, we note that the draft decision includes pass-through treatment for a range of smaller cost components, including AEMO fees, ancillary services, and new cybersecurity-related charges. While individually modest, we consider in the current environment that these costs are increasing in number and complexity, subject to ongoing regulatory change and often uncertain at the time of draft determination. The AEC supports their inclusion as unavoidable costs. However, the cumulative impact of these obligations should not be understated. There is a growing risk that incremental changes in these components, combined with tight margins elsewhere in the cost stack, contribute to a gradual erosion of cost recovery. The AEC supports a pass-through approach for these costs, noting they are externally determined and unavoidable, but considers that a clear explanation of bill impacts will be important.

8. Midday Power Saver

As the Victorian Government has now announced it will mandate a zero-charge period tariff, the Midday Power Saver, and that detailed elements of the offer will be determined by the ESC, we consider it appropriate to comment in this submission on those details.

We understand that the ESC will be responsible for determining the following:

- the free usage periods for each distribution network;
- tariffs for usage outside the free period; and
- tariffs to apply for excess consumption above a fair use cap of 24kWh during the free period.

While the concept of zero-cost energy during periods of high solar generation is intuitively appealing, it raises significant structural challenges when implemented within a regulated pricing framework such as the VDO. In particular, we note that it disconnects prices from underlying costs, creates an inherent revenue shortfall for retailers and requires recovery of costs through other tariff components.

- **Wholesale electricity costs (WEC)** – while the VDO does not allocate costs to specific hours of the day, the WEC reflects the cost of entering into base and cap hedge contracts, which apply across all hours and do not exclude any period of the day.

- **Network costs** – although solar soak tariffs in Victoria may reduce network charges during the free period, these tariffs continue to include a consumption-based charge and therefore do not eliminate network costs entirely.
- **Environmental costs** – estimated by the ESC at \$15.88/MWh, which apply to all relevant electricity supplied.
- **Other variable costs** – estimated at \$0.72/MWh, which similarly continue to be incurred as part of supplying electricity.

It's essential, then, that the Midday Power saver accounts for the unavoidable costs that retailers will incur during the three free hours and allows them to be recovered over the remainder of the day. To this end, the ESC should:

- apply time of use tariffs incorporating the solar soak period as the network component of the Midday Power Saver cost stack; and
- use an appropriate assumption regarding the level of load shifting that customers undertake to benefit from the Midday Power Saver. The assumption should not be zero, as this would systematically understate retailers' efficient costs, while representing an assumption that the policy is ineffective.

The free period should be consistent across the five distribution network regions and should lie wholly within the solar soak period.

Tariffs for the free period for consumption exceeding the fair use cap should be set at a level that allows retailers to begin recovering the losses they will have incurred supplying customers up to the fair use cap.

To the extent the ESC has discretion, controlled loads and batteries should be excluded from participation, given the potential for grid impacts of such loads being activated simultaneously.

Communication protocols, especially interactions with the Deemed Best Offer and other requirements, need consideration, and retailers need time to prepare their systems and processes to be able to meet regulatory requirements.

9. Implementation complexity and regulatory coordination

We note that the 2026-27 VDO is being developed in a context of significant concurrent regulatory and operational change across the energy market. While each of these changes may be manageable in isolation, their combined effect is to increase implementation complexity for retailers. The implications for system and billing changes cannot be understated. These must be delivered within tight timeframes, which greatly increases cost as well as operational and compliance risk. The challenge is compounded this year by the potential requirement for retailers to have a two-step approach to be ready first for the standard VDO from 1 July and then again to be ready for the Midday Power Saver start date of 1 October. To ensure the transition's success, the AEC considers that implementation considerations should form an explicit part of the ESC's decision-making framework. Sufficient lead times, clear guidance, and coordination with other regulatory processes are all critical to ensuring a smooth transition to new pricing requirements.

The AEC appreciates the opportunity to provide input on the 2026-27 Victorian Default Offer and remains committed to working constructively with the ESC through the remainder of the determination process.

Please do not hesitate to contact us if you wish to discuss this submission further.

Yours sincerely,

Jo De Silva

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