Level 6, 179 Queen Street
Melbourne, VIC 3000

info@consumeraction.org.au
consumeraction.org.au
T 03 9670 5088
F 03 9629 6898

25 May 2021

**Submitted via Engage Victoria**

Commissioners
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne, VIC 3000

Dear Commissioners

# Victorian Default Offer 2021 – Variation

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Essential Services Commission's (the **Commission**) consultation paper Next steps for the Victorian Default Offer (the **Consultation Paper**). These comments relate to the approach to vary the Victorian Default Offer (**VDO**).

The Consultation Paper notes the objective of the VDO is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity market.[1] As the Commission has previously noted, this has also been described as 'universal access to a fair priced electricity offer'.[2]

Consumer Action considers that fairness and community expectations demand that the VDO be set at no more than absolutely necessary to ensure bills remain affordable, particularly for those who are unable to effectively engage in the market.

We support the Commission using the variation mechanism to adjust prices for the VDO to account for changes in network tariffs. However, we also believe the VDO could be further reduced including through adjustment of wholesale costs which form the second biggest component of the VDO after network costs. We also urge the Commission to remove the temporary 'bad debt' provision. Our position is that the bad debt provision should never have been included in the VDO.

Our comments are detailed below.

## About Consumer Action

Consumer Action is an independent, not-for profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just marketplace for all Australians.

[1] Clause 3 of VDO Pricing Oder
[2] Commission, Advice on VDO to apply from 1 July 2019, page 14.

# Network tariff structures and prices

### Network costs

We support the Commission varying the VDO to account for changes in network costs. The Australian Energy Regulator (**AER**) has estimated that bills should reduce for most households by between \$60 (United Energy) to \$34 (Powercor) in the next financial year. AusNet customers may see their bills increase by \$27.[3]

The Commission has proposed a start date of 1 August 2021 for the variation. The new network tariffs will take effect on 1 July 2021. We are concerned that if network costs fall (on average) that customers will be paying higher prices than needed in July.

Giving retailers an extra month to charge higher costs – assuming network costs decrease – through the VDO is simply unfair and out of step with a fair and reasonable VDO. The start date for the VDO variation should be the date that reduced network costs take effect: 1 July.

We do not believe that aligning the variation to "potential market contract price changes"[4] is a good reason to charge customers potentially higher prices for a longer period. The Commission also says that a 1 August implementation may reduce retailers' compliance costs. Retailers are already allowed an allowance for regulatory compliance in the VDO so we query this justification.

If the Commission decides to stick with the August date then the profits made by retailers during the month of July should be passed back to consumers in the final VDO price.

**RECOMMENDATION 1.** The start date for the variation should be 1 July 2021 – the date that changes to network costs take effect.

### Tariff structures

We support the Commission's decision to cap non-flat tariffs through specifying a compliant maximum annual bill. This is a simple way to ensure compliance and should allow customers to understand how the VDO impacts them financially rather than a more complicated methodology.

Saying this, we encourage the Commission to monitor the changes to tariff structures and how this impacts customers, particularly customers on low or fixed incomes and who may struggle to pay for energy. Electricity contracts are already confusing for consumers and can exacerbate existing consumer vulnerability.[5] Complex pricing arrangements can also make comparisons difficult. On the face of it, a compliant maximum bill should make things simpler and comparison between offers easier.

We note the Commission will not calculate separate wholesale costs for peak and off-peak periods for the time of use VDO. We encourage the Commission to monitor this as the continued introduction of solar and battery storage into the grid has the potential to drive wholesale prices lower and these benefits should be passed on to consumers.

# Wholesale prices

We are disappointed that falling wholesale costs will not flow through to consumers in this VDO variation despite the Commission acknowledging these price reductions in the Consultation Paper.

In its monitoring of the electricity market, the Australian Competition & Consumer Commission (**ACCC**) released analysis of price changes on 13 April 2021 showing that flat rate offers have fallen in Victoria by 11.1 to 14.2 per cent compared to June 2020 "and a typical household on a flat rate offer should save between \$171 and \$198 a

---

[3] https://www.aer.gov.au/news-release/revenue-for-electricity-businesses-supports-customers-and-networks
[4] Consultation Paper page 5
[5] Exploring regulatory approaches to consumer vulnerability: a report for the Australian Energy Regulator, page 22.

year."[6] The ACCC also noted that spot prices have been significantly lower for a year now. Compared to 2019, average wholesale spot prices have decreased by 58 per cent in Victoria according to the ACCC. These savings should flow through to the VDO.

We have previously criticized the approach used by the Commission to calculate wholesale costs as it risks over-estimating the cost of wholesale energy. Consultancy firm, Frontier, that undertook analysis of wholesale costs in the last VDO reset even acknowledged that by focusing on ASX-traded energy derivatives, while excluding other risk-management strategies that retailers are able to use, will systematically overestimate the hedging component of wholesale costs. These inflated costs are then passed on to households via the VDO.

The simple message on this is that the community expects that decreasing electricity prices will be passed through to consumers and that decreases in wholesale prices should be reflected in the VDO, whatever the methodology used to calculate costs.

**RECOMMENDATION 2.** Falling wholesale electricity costs should be reflected in the VDO.

## Bad debt pass through

The temporary bad debt allowance should be removed as part of this variation. We have noted in previous VDO submissions that the primary service energy retailers provide, since electricity at the point of end use is a physically undifferentiated product, is to offer financial risk-management. On principle, customers should not bear the costs of wholesale market risk including cost impacts of the pandemic.

Calls about energy debts to Consumer Action's National Debt Helpline are the second most identified issue in our data (with credit card debt being the most common issue). In the period July – December 2020 an average of 22 per cent of callers identified an energy issue. Inappropriate hardship assistance were common themes in these calls. Poor or inadequate hardship responses from energy retailers only compound this problem and can result in accumulation of avoidable bad debt if genuine assistance is provided.

Retailers must have an incentive to engage appropriately and assist clients with debt. Ensuring retailers are exposed to the cost of 'mistakes' or sub-optimal risk management strategies also provides an incentive for retailers to manage their operations in a prudent way rather than pass losses through to customers. Figures from the Commission show that there are over a quarter of a million Victorian residential customers in arrears that are not receiving any payment assistance from their retailer.[7] The average arrears of these customers is $495 which would indicate the majority are entitled to assistance under the Payment Difficulty Framework. Allowing energy retailers to simply pass on costs associated with 'bad debt' through the VDO sets up a perverse incentive to let those debts accumulate on the retailers' books knowing that then may be recovered through the VDO.

The Consultation Paper also notes that Origin has carried over its bad debt provisions and AGL has revised their bad debt provisions down by $5 million.[8] On top of this are the large savings being pursued by some retailers. For example, Origin noted in its March 2021 Quarterly Report that they "continue to target significant retail cost savings and are on track to achieve $100 million in savings by the end of FY2021."[9] The Commission is aware of this having said previously that some retailers "have made large savings in costs to serve in recent years, with further savings forecast."[10] If the Commission considers it appropriate to continue to include bad debt forecasts in the VDO then it is arguable that profit forecasts and savings should also be included in the analysis rather than focusing solely on bad debt. The forecasts made by energy companies regarding bad debt during the last VDO determination that informed the current bad provision should also be scrutinised to determine their accuracy.

[6] https://www.accc.gov.au/media-release/900-million-in-electricity-bill-savings-available-to-households
[7] https://www.esc.vic.gov.au/electricity-and-gas/market-performance-and-reporting/energy-customer-support-during-coronavirus-pandemic
[8] Consultation Paper page 15-16
[9] Origin, ASX/Media Release, Quarterly Report March 2021, 30 April 2021
[10] VDO 2021 Draft Decision page 4

We stand by our previous comments that any increase in the cost of managing risk should be borne by retailers, not shifted to individuals or households via the VDO. This is both fair any in line with the principle that risks should be allocated to those best placed to manage them.

**RECOMMENDATION 3.** The temporary allowance for bad debt should be removed as part of this variation.

**RECOMMENDATION 4.** The Commission should scrutinise the information that was used to determine the temporary bad debt provision to determine if the forecasts were accurate.

Please contact **Patrick Sloyan** at **Consumer Action Law Centre** on 03 9670 5088 or at patrick@consumeraction.org.au if you have any questions about this submission.

Yours Sincerely,
**CONSUMER ACTION LAW CENTRE**

Gerard Brody

**Gerard Brody** | Chief Executive Officer