

16 April 2018

By email: RetailEnergyReview@esc.vic.gov.au

Essential Services Commission
Level 37,2 Lonsdale St
Melbourne VIC 3000

Dear Essential Services Commission,

Developing a reference price methodology for Victoria's energy market

Consumer Action welcomes the opportunity to provide a brief submission in response to the Essential Services Commission (**ESC**) Consultation Paper regarding the development of a methodology to determine a reference price for retail energy in Victoria. We appreciate the consultative process that the ESC has undertaken, and the clarity of the Consultation Paper. This is a complex and highly technical policy area to which we do not pretend to have great expertise.

Accordingly, we have limited our comments largely to the principles guiding the methodology, the broader policy context in which the methodology is being developed, and our hopes regarding how the pricing methodology may be used to benefit consumers.

Our further comments are set out below.

About our organisation

Consumer Action is an independent, not-for profit consumer organisation with deep expertise in consumer and consumer credit law, 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 and representation, and policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just market place for all Australians.

1. Is the commission's proposal to adopt a cost-based approach reasonable?

Consumer Action supports the decision to adopt a cost-based approach to determine the reference price. The criteria by which the ESC has arrived at this decision (namely—timeliness, representative, transparent and well accepted) provide a sound decision making framework. It is clear that a cost-

based approach is preferable to an index-based approach, with the proviso that some cost-based approaches fail on the criteria of transparency.

We are aware that the setting of the reference price will be a contested process, and firms may expend significant effort to challenge each element of the ESC's decision. With this in mind, we encourage the ESC to adopt a methodology that, as far as possible, limits ongoing challenges. One consideration is the role of incentives, and whether any incentive could be brought to bear to limit unnecessary contestation from businesses.

The ESC's decision to adopt a futures market method to determine wholesale electricity costs, and a benchmarking approach for determining retail operating costs and margins negates this potential pit-fall, ensuring that the methodology will be reasonably easy to understand and replicable.

Consumer Action notes the ESC's openness regarding flaws and limitations of the proposed methodology, noting in particular that the use of benchmarking approaches for retailing operating costs and margins is not a fully comprehensive approach—but one that will be necessary in the interim given the time and data available. The ESC has acknowledged that reliance on previous ICRC and IPART decisions regarding retail margins is not ideal, as this data is not as current as one would hope.

Importantly, the ESC has been very clear in stating that when providing the reference price and the reference price methodology to government, these flaws and limitation will be very clearly communicated.

We do urge the ESC to review the methodology reasonably regularly to ensure that it takes into account developments in regulatory thinking and approaches. A reference price should not be set forever and should be reviewed and reset at regular intervals. When such reviews occur, it will be important to pay attention to changes in the market, including profits of firms and costs savings gained between reviews.

2. Are there other approaches not outlined in this paper that the commission should consider?

Consumer Action is not aware of other approaches the ESC should consider. The logic by which the ESC has arrived at their proposed methodology is compelling, and comprehensive.

3. Are there any other issues which we should consider?

The reference price is being developed to enable the ESC to fulfil the requirements of recommendation 8A of the *Independent Review into the Electricity and Gas Retail Markets in Victoria (Independent Review)*, a recommendation which was formally supported by the State Government on 11 March 2018 in their Interim Response to that Review.

Recommendation 8A states in part:



"Require the ESC to monitor and report on the competitiveness and efficiency of the Victorian retail energy market."

The reference price will be essential to assessing the efficiency of the Victorian retail market. Despite the potential flaws and limitations of the approach (referred to in our response to question 1 above), Consumer Action considers that it is important to start somewhere—and continue to develop the methodology from that point, as more data becomes available. In time, a more comprehensive approach may well be achievable. The proposed approach is not perfect, but it is the best possible approach in the circumstances—and is commenced with the full and express intention that it will be refined over time.

While it is important to communicate that the approach does have limitations, we also regard it as important that the reference be made public and published widely. While this is not the ESC's decision to make, we do wish to express our view that the reference price will provide an important and useful guide for the market—both the supply and demand side—as to what constitutes a fair price for energy. The degree of price dispersion, and the lack of clarity in marketing that bedevils the retail energy market in Victoria is well documented. These issues were highlighted by the Independent Review, have been identified by the Australian Competition and Consumer Commission (**ACCC**) through their current review of retail electricity pricing, and have been remarked up on the ESC itself—not least of all in the *Victorian Energy Market Report 2016-17*.

A credible reference price has an important role to play in helping to restore balance and fairness to the retail energy market in Victoria. It is very important that this work begins—and the ESC have identified a sound basis on which to begin it.

Finally, Consumer Action notes that the current reference price and reference price methodology are being developed by the ESC for the express purpose of meeting their remit under recommendation 8A of the Independent Review. Inevitably, some in the energy sector have expressed concern that this work may be appropriated for the development of a Basic Service Offer (**BSO**)—the proposal made in recommendation 1 of the Independent Review, which remains under active consideration.

While it would be unrealistic to suggest that the work currently being done by the ESC would not inform a BSO (should it come to pass), Consumer Action does consider these different work streams. The reference price which will be developed through this process is not a proxy BSO. We would expect that should government ultimately adopt recommendation 1, then extensive further consultation would occur in relation to the methodology that would be used to determine the BSO—in whatever form or configuration it eventually takes. While the reference price would inform that process, it would not form the be all and end all of that discussion.



Please contact Zac Gillam, Senior Policy Officer at Consumer Action on 03 8554 6907 or at zac@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

CONSUMER ACTION LAW CENTRE



Gerard Brody
Chief Executive Officer

