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

Marcus Crudden and Dean Wickenton
Director, Price Monitoring and Regulation and Senior Regulatory Manager
Essential Services Commission

Dear Mr Crudden and Mr Wickenton

Victorian Default Offer for domestic and small business electricity customers staff working paper

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Essential Services Commission's (**ESC**) Victorian Default Offer (**VDO**) for domestic and small business electricity customers staff working paper (**staff working paper**).

We strongly support the ESC's work to implement the VDO as a priority. Victorian households must have protected and simple access to a fair price for an essential service. In the period without price regulation many Victorian households have been gouged by energy retailers who have been left to set their own price in a market where households cannot choose to exit. The costs of competition have escalated over time.

For those struggling to make ends meet, the consequences of gouging and the escalating cost of competition are unacceptable. All Victorians deserve access to a guarantee that their energy price is fair and is not unnecessarily compounding any payment difficulty they could be experiencing. No one should be put in position where they must choose to heat or eat.

Getting a fair price without surprises should not rely on a high level of engagement in a complex market. It shouldn't be a job to avoid getting ripped off when accessing an essential service that a household must purchase. There are many who face significant barriers to engaging in the energy market. Just one example is those who face challenges with the numeracy needed to compare a tariff, near one in two people among us.¹ It is in no way fair that people who experience barriers face a price higher than others.

Furthermore, there are many in the community who are unable to cover the costs of high prices, and the deregulated market is putting them at greater risk of financial hardship. Financial hardship is not a fixed attribute, and almost anyone can suffer a financial shock leaving them in hardship.



¹ Australian Bureau of Statistics, 2013. 4228.0 - Programme for the International Assessment of Adult Competencies, Australia, 2011-12.

Victorian households need a fair VDO price on 1 July 2019. There may be difficulties in definitively establishing every aspect of the costs to run an efficient business by this time. Where these difficulties arise, the ESC must make decisions with community expectations front of mind.

The implementation of the VDO must be understood as just one of many changes that will work together to address the mess left by deregulated energy pricing to ensure energy retailers are working in the interests of Victorian households. Over time, the methodology or information available should continue to improve so that the ESC will be better able to transparently demonstrate that the VDO is a fair price. Any decisions made now should not prevent continued improvement in the long-term interests of Victorian households.

Our comments are detailed more fully below.

Desirable policy objectives and principles

- Victorian households have a right to disengage by 'choosing not to choose' in an essential services market that they cannot exit.
- If they make this choice, households must be able to trust that the regulated default offer for disengaged households is a fair price, reflecting the efficient costs of doing business and nothing more.
- Retailers should not make excessive margins off the provision of essential energy services.
- Costs for energy retailers should not be dispersed in such a way that actively engaging is the only way to avoid paying other household's costs.

Consumer Action's key recommendations based on these objectives and principles

1. That the ESC explores the merits of incentivising retailers to create efficiencies and sharing cost savings with their customers.
2. That the ESC adopts the definition of a notional efficient retailer proposed in the staff working paper for this iteration of price setting while transparently informing the community of the model's limitations and leaving room to comprehensively monitor and review this definition, decisions made, assumptions or methodology in future price resets.
3. That the ESC should add 'efficiently complies with Part 3 of the Energy Retail Code' to the definition of an efficient retailer.
4. That the ESC ensures modelling decisions and data assessments for the VDO are transparent and therefore trustworthy for the community.
5. Refunds are provided to households in scenarios where conservative modelling means households are burdened by significant costs that are unnecessary.
6. That the ESC applies published AEMO data in a way that creates the best outcome for Victorian households having difficulty paying their energy bills. This decision making must be transparently explained and trustworthy for the community.
7. That the ESC adopts the tariff structure proposed in the staff working paper and adjusts it if necessary following reviews of the structure's impact over time.



8. That the ESC directly addresses what these changes will mean for embedded network customers in the draft and final decisions for this process.
9. That the first VDO price reset should take place on 1 January 2020.
10. The frequency of price resets from there onwards should be determined on the basis of what is most likely to deliver cost savings to households, particularly those experiencing payment difficulty.
11. That the ESC proceeds with benchmarking but conducts further research and adapts according to the information gathered in future VDO price setting processes.
12. That the ESC scrutinises all claims by industry and transparently demonstrates to the community how it will avoid carrying forward retailer's past inefficiencies.
13. Modest CARC is assessed based on value for money from the perspective of a household experiencing difficulty paying their energy bills.
14. Expensive acquisition practices that are signalled for prohibition not be accounted for in the assessment of 'modest' CARC.
15. That the Government and ESC focus on the feasibility of easy ways for consumers to engage for optimal outcomes in retail markets in the future that do not include excessive retailer spending on CARC.
16. Operating costs include a well scrutinised costing of meeting payment difficulty framework obligations and effective and efficient service quality for all Victorian households.
17. Provision for remuneration be made where conservative modelling results in unnecessary costs to Victorian households.
18. If determined, modest CARC be deducted from the set fair retail margin under the VDO.
19. That the ESC scrutinises any assessment of WACC made in comparison to an industry that is not an essential service with a sticky customer base.
20. That the ESC continues to explore options for lowering energy costs for Victorian households over time.
21. That the ESC actively monitors the VDO's impact and outcomes for all Victorian households accessing essential energy services utilising both qualitative and quantitative methods.
22. That the cost of minimum solar FiT schemes and premium FiT schemes be met by Government revenue.
23. That the VDO becoming available is complemented by a policy to ensure those who need its protection get that protection. This must go beyond information provision.
24. An opt-out universal switch for all households paying above VDO rates be explored by the Victorian Government.
25. That the name for the VDO be mandated to facilitate a simple process for selecting the VDO.
26. That the Victorian Government specify when there will be a VDO for gas services as a priority and immediately replicate the universal obligation to offer.

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 market place for all Australians.



Specific responses to staff working paper questions

1. *Is the definition of a notional retailer suitable for the Victorian retail energy market? What alternatives could we consider for the VDO?*

Consumer Action supports the definition proposed in the staff working paper for the first VDO price setting process. This approach should remove excessively priced default offers like those demonstrated in the second Victoria Energy Compare offer displayed below in *Figure 1*.

Any Victorian can face difficulty paying an energy bill. The consequences for inadequate responses from energy retailers in such cases are unacceptable.² The ESC should also add 'efficiently complies with Part 3 of the Energy Retail Code' to the definition. Consumer Action considers such an efficient retailer would likely save costs due to the reduction of bad debts. Modelling of such costs should not rely on retailer's representations given they have a clear incentive to overestimate these costs. Bad debts were flagged as likely to be a significant proportion of the cost to serve in the ACCC's final report.³ Therefore, a framework which is focused on intervening before debts get out of control should result in efficiencies.

Currently some Victorians may only be able to access the second offer in *Figure 1* if the retailer setting that offer is the financial responsible market participant for their connection point and they are denied market offers by other retailers. Forcing someone onto this excessive price reflects a clear injustice. Most people denied market offers are likely to be in payment difficulty and this excessive price would compound the problems they are facing just for accessing an essential service.

1 January - 31 December		1 January - 31 December	
	Tariff(excl. GST)		Tariff(excl. GST)
Supply charges	91.00 ¢/day	Supply charges	129.00 ¢/day
Flat		Flat	
All consumption	14.87 ¢/kWh	First 344 kWh per month	45.73 ¢/kWh
		Balance	47.35 ¢/kWh

Figure 1. 38c extra per day and more than 3 times the cost per unit! Two tariffs from the same Citipower zone Victoria Energy Compare search, the second is unacceptable yet could be the only option available to a household who is unengaged or has experienced a debt spiral.

While we support the proposed definition of a notional retailer for the first iteration of VDO price setting, it must be reviewed over time to ensure the VDO is realising desirable policy objectives. The current definition seems to be an attempt to allow other players to enter the market and competitively challenge and constrain prices offered by vertically integrated incumbents. Unfortunately, the definition may also

² Consumer Action, 2015. *Heat or eat; households should not be forced to decide whether they heat or eat.*

³ ACCC, 2018. *Restoring electricity affordability and Australia's competitive advantage; retail electricity pricing inquiry – final report*, p.225.

inadvertently allow those 'gentailers' to achieve greater margins as they may have an ability to realise greater efficiencies through economies of scale compared to a new player without generation assets. Such outcomes are not in the spirit of the VDO's purpose. Over time the ESC must monitor whether the definition is effective at delivering fair prices. If it is not, then thought must be put to a mechanism to ensure that households only pay what is fair where such situations arise with the VDO.

Many retailers are vertically integrated. ECA consumer sentiment surveys suggest that the majority of Australian households desire value for money but do not trust the market will deliver.⁴ It is currently possible for small players to enter the market and develop a customer base by offering low prices. Whether or not this is from a loss leading strategy or from efficiencies, the theory is that this activity will encourage incumbents to compete in household's interests by lowering their prices. Unfortunately, in reality the theory has been ineffective.⁵ Something else needs to constrain vertically integrated retailers from gouging their customers or unfairly charging existing customers to attract new customers.

If the definition proposed in the staff working paper is adopted, it is important that 'gentailers' are constrained. Consumer Action recommends the ESC investigate the merits of incentivising efficiencies in retail businesses by allowing retailers to share efficiency savings with customers. How could this work? -If, after a set period for VDO pricing, it is found that a retailer has charged a regulated amount that is in fact greater than their efficient costs for the period (as future ACCC or ESC information gathering powers may assist to establish), then their customers should be remediated the difference less a regulated proportion of efficiency savings.

Reimbursing customers example		
Regulated VDO price for year	Household's price for consumption	\$2,250
Retailer's actual costs for year's supply (revealed after)	Efficient costs actually incurred for consumption including regulated margin.	\$1,700
Savings for efficiencies not accounted for in modelling for regulated price	Row B less row C	\$550
Additional margin allowance to incentivise retailer efficiency	For example, 10% of savings in row D	\$55
Savings reimbursed to the household	Row D less Row E	\$495
These efficiencies influence on future VDO pricing	These incentivised efficiencies may then lower proceeding years prices depending on the methodology.	Downwards pressure on market prices.

⁴ Essential Research, 2018. *Energy Consumers Australia, Energy Consumers Australia Energy Consumer Sentiment Survey December 2018*. Retrieved 28 January 2019 from <https://energyconsumersaustralia.com.au/wp-content/uploads/Energy-Consumer-Sentiment-Survey-Report-December-2018.pdf>

⁵ ACCC, 2018. *Restoring electricity affordability and Australia's competitive advantage; retail electricity pricing inquiry – final report*. And Faulkner, Mulder and Thwaites, 2017. *Independent review of the electricity & gas retail markets in Victoria*.



Such an allowance should not be awarded to the retailer if the discrepancy was the result of misinformation by the industry in the first instance. Such behaviour must also be met with sufficiently deterrent enforcement action including redress for the households impacted.

Consumer Action recommends:

1. That the ESC explores the merits of incentivising retailers to create efficiencies and sharing cost savings with their customers.
2. That the ESC adopts the definition of a notional efficient retailer proposed in the staff working paper for this iteration of price setting while transparently informing the community of the model's limitations and leaving room to comprehensively monitor and review this definition, decisions made, assumptions or methodology in future price resets.
3. That the ESC should add 'efficiently complies with Part 3 of the Energy Retail Code' to the definition of an efficient retailer.

2. *Please provide your views on the time period, buying curve and load profile that are most suitable to the Victorian electricity market.*

Consumer Action does not have specific expertise in this area. It is important that the ESC transparently explain how they arrive at decisions about the most appropriate modelling so that the Victorian community can trust that the VDO price is fair.

As part of a transparent explanation, the ESC must inform the community how it is addressing the potential of gaming of the wholesale market by generators and one-off extreme events that have impacted pricing (such as the closing of the Hazelwood power station) which are unlikely to repeat given reviews and policy responses following such events. The ESC must tell the community how it has avoided carrying forward these costs that may skew the currently available data for assisting the setting of a reasonable VDO price.

Where modelling decisions by the ESC are too conservative, and result in a substantial unnecessary cost to consumers, this fact must be both:

- taken into account as a circumstance by retailers assisting customers in payment difficulty that results.
- refunded to customers who were burdened by such costs as a result of modelling.

Consumer Action recommends:

4. That the ESC ensures modelling decisions and data assessments for the VDO are transparent and therefore trustworthy for the community.
5. Refunds are provided to households in scenarios where conservative modelling means households are burdened by significant costs that are unnecessary.

3. *How should the commission calculate transmission losses?*

Consumer Action agrees that on face value it is appropriate to rely on AEMO published data for decision making on network losses. The ESC must consider the impact of the decision made about how to apply this data while considering the impact on households experiencing payment difficulty and make the decision in



their interests. For example it is likely that more distributed energy resources will mean there are less transmission losses each year which are not accounted for in AEMO historical data. This should be factored in to decisions made by the ESC to ensure savings are delivered for Victorian households as a result of increasing efficiencies. As above this decision making must be transparent and trustworthy for the community.

Consumer Action recommends:

6. That the ESC applies published AEMO data in a way that creates the best outcome for Victorian households having difficulty paying their energy bills. This decision making must be transparently explained and trustworthy for the community.

4. Are the tariffs set out in Tables 1 and 2 the appropriate tariffs to use for establishing the VDO?

Consumer Action supports this approach for the initial VDO price setting process. Some stakeholders may raise concerns that setting only one residential tariff in each distribution zone may create undesirable cross subsidies between households. While this might be the case, it appears unlikely that the uptake of the VDO will be immediately uniform after the implementation on 1 July 2019 given consumers current tendency to remain as 'sticky' customers⁶ and no policy intention or initiative from the Victorian Government to strongly encourage a uniform switch to this offer.

That is not to say these issues may not arise over time and that setting more VDO prices or structures on a more granular basis may become necessary. The ESC should therefore proceed with the proposed tariffs in the staff working paper, monitor the impacts against the desired policy outcomes and review the approach taken to ensure policy objectives are being met over time. At every stage consulting consumers and community organisations will be essential.

Simplicity in the initial VDO price setting by the ESC is appropriate given research and resource limitations. Research points to the community desiring or needing simplicity in the energy market.⁷ Simplicity in the VDO tariff's application is also likely to mean they are better understood and therefore trusted by the community.

The ESC must also acknowledge Victorians in embedded networks in the draft decision and indicate the anticipated impact of price setting decisions on the default pricing arrangements will have on households in embedded networks. Households in embedded networks are often supplied essential energy services through effective monopoly arrangements and deserve the protection of a regulated fair price like their peers.

Consumer Action recommends:

⁶ Essential Services Commission, 2018. *Victorian Energy Market Report 2016-17*.

⁷ Behavioural Insights Team, 2018. *Final report BIT review of Basic Plan Information Document (BPID)*. Available at:

https://www.aer.gov.au/system/files/Review%20of%20Basic%20Plan%20Information%20Document%20-%20Final%20Report%20-%20April%202018_0.pdf and Consumer Action, 2016. *Power Transformed; unlocking effective competition and trust in the transforming energy market*.



7. That the ESC adopts the tariff structure proposed in the staff working paper and adjusts it if necessary following reviews of the structure's impact over time.
8. The ESC directly addresses what these changes will mean for embedded network customers in the draft and final decisions for this process.

5. *How should we treat the calendar year network revenue determinations in the context of the introduction of the VDO from 1 July 2019?*

The first reset after implementation should occur on 1 January 2020. There are several advantages to this timing:

- It will align changes with AER network revenue determinations
- It will allow the ESC to apply learnings from the initial impact of the VDO to a reset in the interest of Victorian households sooner rather than later
- Other policies resulting from the Twaites or ACCC reviews may be implemented at this time that may complement the VDO and require an adjustment in the way it is set.

It also seems unclear from the staff working paper as to how often regulated prices will be reset. This frequency must be determined with the objective of ensuring it enables the greatest cost savings to Victorian households, particularly those having difficulty paying their energy bills.

Consumer Action recommends:

9. The first VDO price reset should take place on 1 January 2020.
10. The frequency of price resets from there onwards should be determined on the basis of what is most likely to deliver cost savings to households, particularly those experiencing payment difficulty.

6. *Do you agree with our proposed approach of using benchmarking? If not, why not, and what alternative approach should we consider?*

Consumer Action accepts the pragmatic reality that the regulator must undertake a benchmarking approach for determining efficient retail operating costs when setting the initial VDO prices. However, it is important that retailer inefficiencies are not carried forward wherever possible in the initial price setting process and that over time the ESC conducts further research using future information gathering powers or other sources of information to utilise a bottom up approach in the interests of Victorian households.

While much may be made by industry of regulatory costs due to jurisdictional differences, the estimated \$11 per customer figure landed on by the ACCC is not insignificant but much smaller than other findings on costs that have no value to customers such as Customer Acquisition and Retention Costs (CARC). This figure must be further scrutinised where possible given that the ACCC based this estimation on information volunteered or asserted by industry.⁸

⁸ ACCC, 2018. *Restoring electricity affordability and Australia's competitive advantage; retail electricity pricing inquiry – final report*, p.226-27.



It must also be recognised that while the ACCC recommended that Victoria align with the NECF to reduce these regulatory costs to retailers, it ignored the value of the superior consumer protections to Victorian households and the benefits to other jurisdictions where nationally operating staff receive more advanced training than they would otherwise. The new payment difficulty framework is a case in point.

In fact, scrutiny must be applied to every aspect of retailer's current costs to ensure that previous inefficiencies aren't brought forward. Multiple reports have questioned many different inefficiencies within retail operations and CARC.⁹ The ESC must transparently indicate how it is addressing such inefficiencies to the community in order to justify that the VDO is a reasonable price that can be trusted.

For example, the 10 per cent per year added to the spot price to compensate retailers for the cost of holding certificates on page 14 of the of the staff working paper is not clearly justifiable on the basis of the information presented in the staff working paper.¹⁰ How is this determined and why is it fair that Victorian households pay this amount?

Consumer Action recommends:

11. That the ESC proceeds with benchmarking but conducts further research and adapts according to the information gathered in future VDO price setting processes.
12. The ESC scrutinises all claims by industry and transparently demonstrates to the community how it will avoid carrying forward retailer's past inefficiencies.

7. What should be included as efficient retail operating costs and a modest customer acquisition and retention costs allowance?

Customer Acquisition and Retention Costs

Consumer Action supported the Basic Service Offer proposal which excluded CARC. The ACCC's final retail electricity pricing inquiry report shows no evidence of CARC providing value for households. Instead, most of the marketing of energy retailers appears to be based on aggressive practices (unsolicited or 'win back' selling) or misleading and trick practices (discounting etc). Figures reported about the likely amounts being spent on CARC in Victoria are appalling and can by no means be considered 'modest'. CARC has been suggested to possibly amount to between \$59 and \$283 per household according to different criteria for analysis. Either of these amounts are not justifiable for an essential service. We would consider that 'modest' means something lower than \$10 per household by comparison, if CARC is not rightly scrapped altogether.

All households should be able to access a low price for their essential energy services without unnecessarily covering the costs of excessive sales commissions, billboards, television advertisements or glossy brochures for a service that is for the most part homogenous and that they cannot choose not to consume.

⁹ Ibid and Faulkner, Mulder and Thwaites, 2017. *Independent review of the electricity & gas retail markets in Victoria*.

¹⁰ ESC, 2018. *Victorian Default Offer for domestic and small business electricity customers; staff working paper*, p.14.



In fact, community expectations have been identified within the policies proposed by a re-elected Victorian Labor Government.¹¹ Victorian households do not want unsolicited energy offers or win-back calls with competitive offers which are only available when they depart a retailer; why should they then pay for these under an efficient default offer? Why should a household incur wasted acquisition costs for a different customer where a 'save' or 'win back' for that customer is successful? Why waste all Victorian households \$59 a year on average?¹².

The ESC must assess modest CARC from the perspective of Victorian households who are struggling to make ends meet. These households were no doubt amongst those surveyed for the ECA who feel they are not getting value for money.¹³ The ACCC found that marketing and advertising costs were higher in Victoria than elsewhere, so too costs incurred by customers being acquired through third party aggregators (with indication that these amount to around over \$200 commissions¹⁴). Both services are useless to a customer choosing to rely on the fair VDO price as opposed to constantly comparing market offers.

CARC encourages switching which the ACCC reports increases CARC, thus disproving the theory that switching will cause retailers to lower costs to households.¹⁵ The big three were estimated to spend \$283 to acquire a customer. This in no way can be viewed as modest.

Initiatives like green button and consumer friendly mechanisms to enable comparison should be thoroughly investigated by Government in an attempt to advance efficiencies in competitive markets. Such measures are ideal when compared to the poor value for money advertising that people cannot opt out of paying for.

Retail operating costs

As for efficient retail operating costs, the ESC must make an assessment of community expectations around the minimum quality of service and the adequate funds necessary to ensure compliance in assisting customers experiencing payment difficulty according to part 3 of the Energy Retail Code. These costs should not be unevenly allocated between default and market contracts. While some more than other Victorian households are at risk of experiencing payment difficulty, anyone can. All should contribute equally to the safety net for accessing essential services, so it is there when they need it.

A customer on a default offer must also be able to opt in for paper billing (without cost), pay by any means that suits them, have access to a call centre capable of solving issues in a timely way and receive free energy

¹¹ Victorian Labor, 2018. *Fact Sheet; Cracking down on dodgy energy retailers – Labor's energy fairness plan*. Retrieved 28 January 2019 from;

[https://static1.squarespace.com/static/5b46af5a55b02cea2a648e93/t/5bf3264f21c67ce36dc6f142/1542661716026/CRACKING+DOWN+ON+DODGY+ENERGY+RETAILERS+%E2%80%93+LABOR%E2%80%99S+ENERGY+FAIRNESS+PLAN+\(1\).pdf](https://static1.squarespace.com/static/5b46af5a55b02cea2a648e93/t/5bf3264f21c67ce36dc6f142/1542661716026/CRACKING+DOWN+ON+DODGY+ENERGY+RETAILERS+%E2%80%93+LABOR%E2%80%99S+ENERGY+FAIRNESS+PLAN+(1).pdf)

¹² ACCC, 2018. *Restoring electricity affordability and Australia's competitive advantage; retail electricity pricing inquiry – final report*, p.230, figure 10.6.

¹³ Essential Research, 2018. *Energy Consumers Australia, Energy Consumers Australia Energy Consumer Sentiment Survey December 2018*. Retrieved 28 January 2019 from <https://energyconsumersaustralia.com.au/wp-content/uploads/Energy-Consumer-Sentiment-Survey-Report-December-2018.pdf>

¹⁴ ACCC, 2018. *Restoring electricity affordability and Australia's competitive advantage; retail electricity pricing inquiry – final report*, p.231.

¹⁵ Ibid, p.229.



conservation advice free of charge. If this means cost to a retailer, the efficient costs to do so must be assessed thoroughly by the regulator before being included in VDO pricing.

When assessing the 'strike' modelling produced by Frontier Economics, the ESC must consider that it is likely to be conservative given common practices of economic professionals around dealing with assumptions. This will likely result in cost being modelled higher than will be the case. Where the modelling leads to costs being significantly lower than modelling the community should be refunded for costs incurred. As discussed above, the ESC should also investigate whether there is a way to incentivise industry to stride towards further efficiencies and share the resulting savings with their customers.

The ESC must set out how it will monitor the impact of and respond to make adjustments rapidly in the interests of consumers for all decisions made in this and other areas of the price setting process.

Consumer Action recommends:

13. Modest CARC is assessed based on value for money from the perspective of a household experiencing difficulty paying their energy bills.
14. Expensive acquisition practices that are signalled for prohibition not be accounted for in the assessment of 'modest' CARC.
15. That the Government and ESC focus on the feasibility of easy ways for consumers to engage for optimal outcomes in retail markets in the future that do not include excessive retailer spending on CARC.
16. Operating costs include a well scrutinised costing of meeting payment difficulty framework obligations and effective and efficient service quality for all Victorian households.
17. Provision for remuneration be made where conservative modelling results in unnecessary costs to Victorian households.

8. For electricity retailers—how readily can you separate customer acquisition and retention costs from other operating costs? What issues might we need to consider?

Consumer Action understands that CARC spending currently depends on each individual retailer's discretion. The ESC must ensure costs are not counted twice so that the VDO is a fair price. It is likely that most retailers spend on CARC from the same 'bucket' as operating costs or make provision to cut into margins.

If the ESC can determine what a modest amount of CARC is it should be deducted from allowance for a fair margin, leaving businesses with an incentive not to spend on acquisition and retention unless necessary.¹⁶ This is in the interests of consumers as it would counter the escalating cost of competition that delivers no benefits to households. As the Independent Review of The Electricity & Gas Retail Markets in Victoria review (**the Thwaites review**) pointed out, there is a precedent for regulated prices without CARC in the Australian Capital Territory.¹⁷

¹⁶ This has also recently been pointed out here: Public Interest Advocacy Centre, 2018. *Submission to Default Market Offer Price position paper*, p.5.

¹⁷ Faulkner, Mulder and Thwaites, 2017. *Independent review of the electricity & gas retail markets in Victoria*.

Deducting CARC allowance from a fair margin for retailers	
Example fair margin for retailer	4.9%
Example 'Modest' CARC allowance	.1%
Profit margin retailer retains if all CARC allowance is spent	4.8%

Consumer Action recommends:

18. If determined, modest CARC be deducted from the set fair retail margin under the VDO.

9. Are there any other costs incurred by an electricity retailer that we should consider? Why?

It is important that the assessment and application of the weighted cost of capital (**WACC**) is not too conservative (that is, too high). Incumbent energy retailers have large customer bases, the vast proportion of which are 'sticky'. Given this, there is actually low risk to these retailers in terms of ongoing revenue. It should also be recognised that energy is an essential service, thus there will always be a large customer base. Given this, the WACC should not be set as if these are risky investments.

Consumer Action supports the ESC continuing to explore whether retail margins reducing incrementally at each price reset or other approaches might be in the long-term interests of Victorian households. It is important that in the future community organisations have access to appropriate resources to scrutinise approaches that are made transparently by the ESC about the VDO price.

Consumer Action recommends:

19. The ESC scrutinises any assessment of WACC made in comparison to an industry that is not an essential service with a sticky customer base.

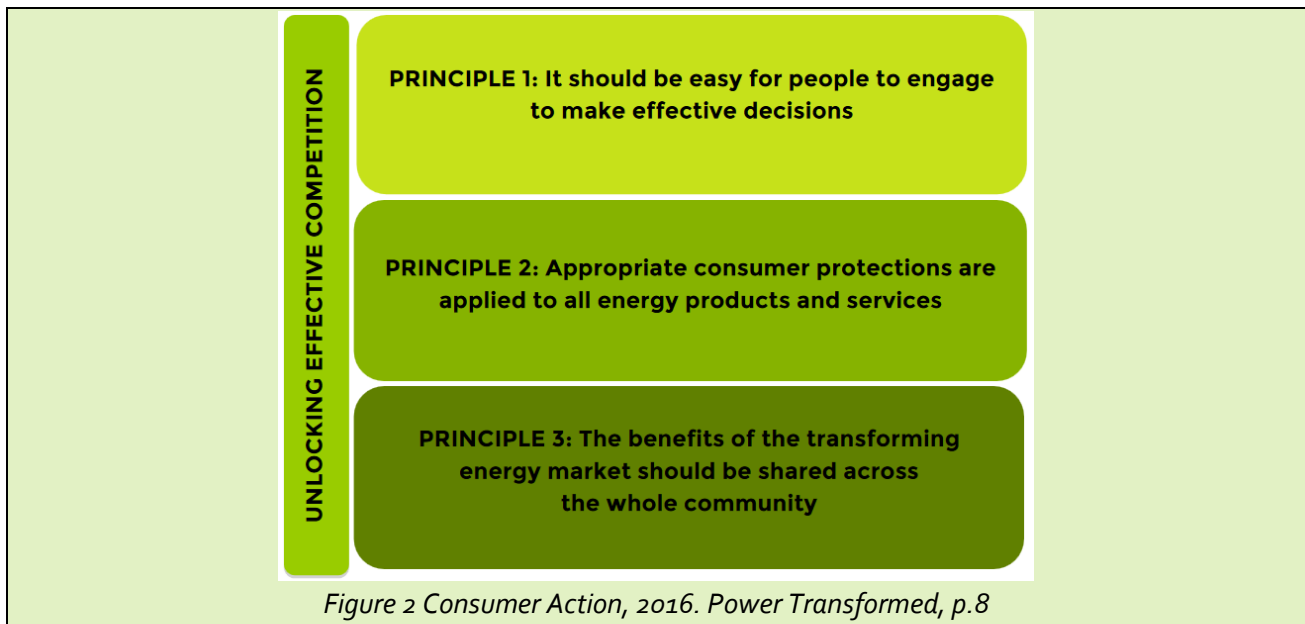
20. The ESC continues to explore options for lowering energy costs for Victorian households over time.

10. Does this proposed structure provide a simple and practical approach to deal with the variety of standing offers?

A simple tariff structure makes sense for a 1 July implementation and in cohesion with other policy initiatives, such a structure may quickly deal with excessive gouging issues in the retail energy market. In implementing this simple structure now, it must be recognised that over time there needs to be an ongoing review as to whether this structure is delivering for Victorian households given costs can often be shifted between customers with different load profiles.

Consumer Action's Power Transformed report offers the below guiding principles as Australia transitions to an increasingly complex energy market. Of particular note and as already discussed in our response to question four – households value simplicity. The tariff structure proposed delivers just that for the initial VDO price.





It should also be noted that it appears that the concurrent work on the Default Market Offer by the Australian Energy Regulator will likely offer further insights as to the impacts of a different model for structuring regulated pricing.

Consumer Action recommends:

7. The ESC adopts the tariff structure proposed in the staff working paper and adjusts it if necessary following reviews of the structure's impact over time.

11. What other approaches to cost allocation would you consider appropriate?

As above, this process is one of many policy changes to swing the operation of energy retailers back into the interests of all consumers. At this stage it appears best that the ESC proceeds with the simple approach proposed in this staff working paper, monitor the impacts and discover, implement and regularly review the best approach to cost allocation overtime in the interests of all Victorian households.

Qualitative not just quantitative measures are important in determining whether the VDO is actioning the desired policy objectives after implementation. Often in the past regulators have focused on metrics like switching rates to say that competition is effective and therefore households are getting good outcomes. Other sorts of evidence need to be considered, including survey evidence. Even a day spent listening to the experiences of callers to the National Debt Helpline in Victoria would draw a very different conclusion about the effectiveness of the retail energy market, let alone assessing what rates they are being given for essential services. As has been a theme throughout this submission – the Victorian community must be able to trust that they can access a guaranteed fair price for energy. Monitoring should examine whether this is increasingly the case or not as well as many other phenomena following the initial availability of the VDO.

Consumer Action recommends:

21. The ESC actively monitors the VDO's impact and outcomes for all Victorian households accessing essential energy services utilising both qualitative and quantitative methods.

Other comments

No one policy measure will solve all the issues in the retail energy market. The process discussed in this staff working paper is limited to implementing a set of terms of reference according to policy that has already been established. However, it is important that other policy questions that are addressed in this submission are considered, noting some may be the responsibility of the Victorian Government but also interact with the VDO price setting process (e.g. how customers access the VDO, opt-in or opt-out or some other way).

Solar and other new energy products and services

As stated above, cost allocation between those able and unable to access solar should be considered. Consumer Action reiterates our previous comments on Feed in Tariff (FiT) costs:

Costs for minimum FiT should be recovered through government revenue

Energy is an essential service and better environmental outcomes will benefit all. However, FiT schemes can be regressive in nature as energy must be purchased by all, and those with the least income incur the greatest cost to pay for FiT (as a proportion of their income). Consumer Action recommends recovering the cost of minimum FiT and premium FiT from government revenue which is a fund more often made up of progressive taxation. This would lead to a more equitable division of the costs associated with the universal benefit from the transforming energy market. Alternatively, there needs to be stringent and robust monitoring programs introduced, to identify the effect of FiTs on distribution and cost, which can then be addressed transparently.¹⁸

It is also worth noting that a VDO price is likely to promote real innovation during the transition. If Victorian households can trust that they have access to a simple and fair price for energy it is likely to improve ease with which they can engage in the acquisition of new products and services that have better cost and environmental outcomes. As outlined in *Power Transformed*, the benefits of such transition should be shared across the whole community. Regulators and Government are ultimately responsible for facilitating this.

How will Victorian households end up on the default offer?

The deregulation of energy retail pricing has failed. Time and time again decision makers have looked to greater information provision as a solution to improve outcomes for all households. Instead, protections must go further than information provision as this may empower some but has failed to help all with fair access to essential energy services.

We welcome the VDO as it is a major piece in the puzzle to overcome the failures of the deregulated market. However, informing consumers who are not getting a fair price that the VDO exists will be insufficient to nudge all of this cohort into taking up the VDO's protections. Another mechanism must be implemented with the purpose of making sure those who need the protection of a regulated fair default price end up protected.

¹⁸ Consumer Action Law Centre, 2018. *Submission: Minimum electricity feed-in tariffs to apply from 1 July 2018 draft decision*, p.5.



Consumer Action has long pointed to those on evergreen market offers where benefits have expired as the cohort of Victorian Households most likely to be suffering detriment as a result of the deregulation of energy retail pricing. Frustratingly there is little information available about how many people are in this cohort but the AEMC's 2017 reporting of 47 per cent of households who had not switched in five years may give an indication of the risk posed by these offers given most benefit periods are 24 months or less.¹⁹

Artificially inflated base rates or standing offers to allow for higher headline discounts are also of concern. The ACCC found that many miss out on these artificial discounts, including a cohort of households who would be most impacted by greater energy costs and are disproportionately penalised when they miss out on 'discounts' 59 per cent of the time.²⁰

Paying a day late on a bill should not incur a penalty of more than half a thousand dollars. Consumer Action has seen billing where such a scenario arose for a single mum trying to make ends meet. We can also still see offers on Victoria Energy Compare that would enable the same scenario to arise from retailers who are still spruiking big discounts in advertising campaigns.

Information provision has failed to address these now well recognised issues. The Victorian Government must start work on a mechanism to ensure the mess left from deregulated pricing is cleaned up fast. Academic research has found that even in the most favourable conditions consumers are unlikely to switch energy retail providers.²¹ It can also be observed that even with a \$50 incentive and accompanying promotional campaign pushing a possible saving of hundreds of dollars for looking at switching through the Victorian Energy Compare website, not all Victorian households have done so.

From an initial analysis Consumer Action considers an opt-out transition to the VDO for any household being charged above that price may be a necessary reset. Other options could be explored, including the potential effectiveness of the accepted recommendation 4c from the Thwaites review - that people be defaulted to the nearest offer when benefits have expired. Whatever becomes the case it must be recognised that information provision alone is not sufficient.

Related to these considerations is the name of the VDO. The ESC and the Government must ensure that consistent naming of the offer is mandated so that it is simple to access. The clear advice principle²² to be rolled out at the same time may help people access market offers if they are more appropriate to their circumstances but households must be able to 'choose not to choose' with ease by selecting the VDO and having a retailer respond by accepting it has an obligation to offer the VDO to the household.

¹⁹ AEMC, 2017. *2017 AEMC Retail Energy Competition Review*, p.4.

²⁰ ACCC, 2018. *Restoring electricity affordability and Australia's competitive advantage; retail electricity pricing inquiry – final report*, p.264.

²¹ Deller, David et al. *Switching Energy Suppliers: It's Not All About The Money*, Centre for Competition Policy, University of East Anglia, 2017, p. 1. Available at:

<http://competitionpolicy.ac.uk/documents/8158338/17199160/CCP+WP+17-5+complete.pdf/fdaaed88-56e5-44f9-98db-6cf161bfb0d4>

²² ESC, 2018. *Building trust through new customer entitlements in the retail energy market; final decision*.



Gas

Gas makes up a large proportion of Victorian household's energy supply. The Government must give a strong indication of when a VDO for gas will be set. The ESC must also closely monitor retailer's behaviour in the gas market following the implementation of the VDO for electricity.

We strongly support the obligation for each licensed retailer to offer the VDO for electricity and this should also be the case for gas as well. This should be limited to exiting gas connections but should be progressed as soon as possible to avoid unnecessary complication and confusion for households, particularly those having difficulty accessing a gas market offer.

Consumer Action recommends:

22. The cost of minimum solar FiT schemes and premium FiT schemes be met by Government revenue.
23. The VDO becoming available is complemented by a policy to ensure those who need its protection get that protection. This must go beyond information provision.
24. An opt-out universal switch for all households paying above VDO rates be explored by the Victorian Government.
25. That the name for the VDO be mandated to facilitate a simple process for selecting the VDO.
26. That the Victorian Government specify when there will be a VDO for gas services as a priority and immediately replicate the universal obligation to offer.

Please contact Jake Lilley on 03 9670 5088 or at jake@consumeraction.org.au if you have any questions about this submission.

Yours Sincerely,

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