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Commissioners
Essential Services Commission
Level 37, 2 Lonsdale Street
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Dear Commissioners

Victorian Default Offer 2022

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Essential Services Commission's (the **ESC**) Draft Decision: Victorian Default Offer from 1 January 2022 (the **draft decision**).

The draft decision paper states 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.

Overall, we are pleased to see that the VDO will decrease on average for residential customers. We know through our case work that many Victorian households find electricity costs unaffordable and decreasing prices should be welcome news. We are strongly supportive of the decision to remove the temporary bad debt provision. We believe this should never have been included in the VDO.

We are supportive of the approach to calculating wholesale costs over 12 months as this should better reflect actual costs worn by retailers and work in the long-term interest of Victorian consumers.

We also provide comment on the Victorian Energy Upgrades program and how this factors into the VDO price.

Recent legislative reforms in Victoria will see the banning of unsolicited selling of energy and restrictions on other marketing practices. We believe that costs associated with these marketing practices should be removed from 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

[1] Draft Decision page 2; Clause 3 of VDO Pricing Order
[2] ESC, Advice on VDO to apply from 1 July 2019, page 14.

work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just marketplace for all Australians.

Wholesale prices

We are supportive of the ESC's approach to use a 12-month period to calculate wholesale costs for the 2022 VDO. Using only a 6-month average wholesale cost for the first half of 2022 (a period for which wholesale costs are generally higher compared to the second half of the year) would be inconsistent with past reviews, ignores the reality of retailer hedging behaviour and carries the risk that the VDO will fluctuate in the next reset which is not in the long-term interest of Victorian consumers. In particular, we note that the ESC's proposed approach is consistent with its initial approach to the VDO taken in 2019, which also covered a six-month period.[3]

We also reiterate our position that the approach used by the ESC is conservative and should be treated as an upper bound rather than an efficient estimate. We appreciate the ESC addressing our concerns in the draft decision paper. However, given that Tier 1 retailers cover more than 50% of the market we believe consideration should be given to the models used by these big "gentailers" and models used by other established energy companies that contract directly with generators, for example.

In addition to lower wholesale costs, 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.

Recent research has noted that Tier 1 and Tier 2 retailers (89% of the Victorian retail market) do not fully pass through reductions in wholesale costs to their customers. Victorian Energy Policy Centre analysis concluded that first and second tier "retailers are passing through less than half of the wholesale price variation in their retail offers".[4] Given that 3 out of 4 electricity customers are not on the best offer[5] it would seem that this incomplete pass through practice by the tier 1 and 2 retailers also "provide[s] some level of insulation from wholesale price volatility".[6] It is important that the regulator puts downward pressure on electricity costs through the VDO to ensure lower wholesale prices are flowing through to customers.

We stated at the public forum on this VDO draft decision that there is a risk that consumer trust in the VDO is undercut when wholesale costs are falling by 25% but the VDO is only decreasing by 5% for residential customers.[7] We strongly encourage the ESC to ensure that lower wholesale costs are reducing household bills rather than increasing the profits of energy companies.

Bad debt pass through

We strongly support the removal of the bad debt pass through.

Including bad debt costs in the current VDO was wrong in principle. We wrote in previous VDO submissions that the primary service energy retailers provide, since electricity at the point of end use is a physically undifferentiated

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[3] See: https://www.esc.vic.gov.au/electricity-and-gas/inquiries-studies-and-reviews/electricity-and-gas-retail-markets-review-implementation-2018/victorian-default-offer-recommendation-2019

[4] *Do wholesale electricity prices pass-through to consumers in contestable retail electricity markets? An examination in Victoria, Australia*, VEPC Working Paper WP2108, Kelly Burns and Bruce Mountain, page 27

[5] Victorian energy market update: June 2021

[6] *Do wholesale electricity prices pass-through to consumers in contestable retail electricity markets? An examination in Victoria, Australia*, VEPC Working Paper WP2108, Kelly Burns and Bruce Mountain, page 27

[7] See: https://www.esc.vic.gov.au/electricity-and-gas/prices-tariffs-and-benchmarks/victorian-default-offer/victorian-default-offer-price-review-2022#toc--our-draft-decision

product, is to offer financial risk-management. Customers should never have worn the costs of wholesale market risk due to the financial impacts of the pandemic.

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. Ensuring retailers are exposed to the cost of ‘mistakes’ or sub-optimal risk management strategies provides an incentive for retailers to manage their operations in a prudent way rather than pass losses through to customers. This is both fair and in line with the principle that risks should be allocated to those best placed to manage them.

As the ESC has stated, the level of bad debts in 2021 have been lower than expected, and that new bad debts retailers expect to face in 2022 is lower than it was for 2021.[8] This is confirmed in data published by the ESC – the number of customers with arrears has actually stabilised in August 2021, and has not increased, and the average arrears has similarly not increased.[9] The draft decision also notes that “Publicly listed retailers’ statements to market show the level of bad debts in 2021 has been lower than expected”.[10]

While the recent restrictions in Melbourne and regional Victoria have no doubt impacted many people, the Reserve Bank of Australia has stated that “the setback to the economic expansion in Australia is expected to be temporary” and “the economy is set to bounce back”.[11] Moreover, the Payment Difficulty Framework has an important role to play—it should ensure retailers assist people early to avoid debt build-up and disconnection. The VDO also includes allowances for regulatory compliance, including the Payment Difficulty Framework, so we consider it to be potentially double-dipping to continue to allow an additional recovery in the VDO for bad debts.

Victorian Energy Upgrade costs

We are concerned that environmental costs are higher in this draft decision than the allowance included in the 2021 VDO. We understand that changes to the scheme and impacts of the pandemic have resulted in VEU certificate prices being higher than average. We are supportive of the draft decision’s approach to stick with a 12 month weighted average to forecast certificate prices.

We disagree with retailers that are advocating for an adjustment to the VEU certificate prices based on recent price fluctuations. We also disagree that retailers should be able to claim the cost of penalties for not meeting VEU obligations through the VDO. We have said in this and previous VDO submissions that the primary role of retailers is to manage risk. Retailers could be innovating and more actively engaging in this scheme to reduce the prices of certificates and therefore costs to comply with the scheme. This behaviour would make sense in a functioning market. Advocating for simple cost pass throughs so that consumers are burdened with the results of poor risk management is lazy and poor business practice.

While we are strongly supportive of efforts to improve energy efficiency of Victorian households, the pandemic and extensive lockdowns in Victoria have clearly had an impact on this scheme. It is important that the ESC and Government take this into account and allow flexibility so that consumers are not burdened with energy higher bills through no fault of their own.

[8] Draft decision, page 4
[9] See page 5: https://www.esc.vic.gov.au/electricity-and-gas/market-performance-and-reporting/energy-customer-support-during-coronavirus-pandemic
[10] Page 4. We note that Ofgem has recently consulted on a ‘true-up’ process to adjust initial COVID related debt allowances to reflect final / actual costs incurred by domestic energy suppliers.
[11] Media Release, *Statement by Philip Lowe, Governor: Monetary Policy Decision*, 5 October 2021, https://www.rba.gov.au/media-releases/2021/mr-21-22.html

Customer acquisition and retention costs

The Victorian Government has recently introduced new rules for energy retailers that restrict certain sales practices including a prohibition on door-to-door sales, cold calling and restrictions on "win-back" practices when customers switch retailers.[12] Consumer Action strongly supports these measures as they will ensure high pressure sales practices in the energy market that can disproportionately affect consumers in vulnerable or disadvantaged circumstances (door-to-door sales, cold calling) or impede consumer choice (win-back practices) are stamped out.

These law reforms will necessitate changes by retailers as these costly marketing practices will no longer be permitted. As such, the allowance for consumer acquisition and retention costs (**CARC**) in the VDO should be reduced.

As Consumer Action has consistently outlined, CARC are not efficient or likely to be incurred by households on the VDO who are less likely to switch retailers. Ideally there would be no allocation for CARC made in the VDO. However, the Order in Council relating to the ESC's calculation of the VDO requires a 'modest' allowance for CARC. The ESC must place pressure on retailers to increase efficiency of spending and decrease CARC over time to align with the requirement of 'modest' costs. The ESC should signal to retailers that the community expects electricity prices to lower with increasingly modest unnecessary CARC costs. To do this, the ESC should reduce CARC costs based on the forthcoming reforms and remove the proportion of CARC that enabled excessive spending on unsolicited selling and "win-back" practices. The ESC should also consider setting a progressively lowering benchmark for CARC costs at each VDO reset.

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

[12] *Energy Legislation Amendment (Energy Fairness) Act 2021* (Vic), passed 10 August 2021.