

28 April 2022

## Submitted via Engage Victoria

Manager, Review of the Victorian Default Offer Order in Council,  
Energy Sector Reform  
Department of Environment, Land, Water and Planning  
PO Box 500  
East Melbourne VIC 3002

Dear Expert Chair,

## Review of the Victorian Default Offer Order in Council

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Victorian Government's review of the Order in Council (the **Order**) that was used to give effect to the Victorian Default Offer (the **VDO**).

Consumer Action have long supported the recommendation of the Independent Review of the Electricity & Gas Retail Markets in Victoria (known as the **Thwaites Review**) to establish a basic, unconditional, regulated price for energy and have been involved in the development and setting of the default offer for electricity. We believe all Victorians have the right to choose not to engage in a retail market which they are unable to exit. For these households, and particularly where people may be experiencing financial hardship, it is critical that people have protected access to a simple and fair price for an essential service.

Overall, we consider that the introduction of the VDO has been effective in achieving the objective of ensuring that Victorians unable or unwilling to engage in the electricity retail market receive a fair price for their electricity service. This is clear from the continual downward trend in annual bills for customers on standing offers since the introduction of the VDO.

Given this outcome, we are of the view that the introduction of the VDO has been an overall positive for Victorian consumers, and therefore consider the VDO Order in Council can largely be retained as currently written. Despite the success of the implementation of the VDO to date, we consider that there are several improvements which can be made. As part of this review, we recommend the following changes be made to the Order in Council to further improve consumer outcomes under future VDO determinations:

- Expanding the Order to include an opt-out switch to the VDO for any household on a legacy market offer in excess of the VDO price.
- Including a productivity factor as an item the ESC must consider when making a VDO price determination.
- Expanding the Order to direct the ESC to use the lowest figure in any range of cost estimates when making price determinations.
- Removing the need for the ESC to have regard to customer acquisition and retention costs when making VDO price determinations.
- That the duration for each regulatory period be retained at 12 months, with the ESC able to vary the length when required due to unforeseen circumstances.
- Extending the Order to introduce a VDO for gas as a matter of priority, so that consumers using both fuel types are covered by the same protections.

More detailed comments on these points, as well as responses to select questions from the Consultation Paper, are provided 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.

## Responses to select questions from the Consultation Paper

### Does the retail data for residential and small business customers demonstrate that the policy objective of the VDO is being achieved?

Overall, we believe that the VDO has achieved its stated objective to ‘...provide a simple, trusted and reasonably priced electricity offer that safeguards electricity consumers who are unwilling or unable to engage in the electricity retail market’<sup>1</sup>. Consumers should not be penalised by having to pay exorbitant electricity prices for an inability or unwillingness to engage in the market for an essential service. People calling our financial counsellors to discuss energy-related issues often report dealing with a myriad of challenges in their lives, whether that be experiencing mental health issues, caring for an unwell family member, or having experienced family violence. We consider that the VDO is functioning as an effective safety net, ensuring that people who either choose not to engage in the electricity market, or are precluded from doing so by circumstances outside of their control, are able to access a fair and trusted electricity price. This allows people to devote their energies to addressing other issues they may be facing, rather than pouring significant time and resources into chasing a reasonably priced retail market offer.

As noted in the Consultation Paper,<sup>2</sup> prior to the introduction of the VDO the median annual bill for a person on a standing offer in Victoria was \$1788. Prices have trended down since that time, with the Essential Services Commission’s (the **ESC**) draft decision for the 2022-23 VDO setting the price at \$1361.<sup>3</sup> With electricity being one of the larger household expenses, this reduced cost will have made a significant contribution to easing financial stress for households, particularly where people are on low or fixed incomes. Given that the VDO appears to be achieving its policy objective, we recommend that through this review that the majority of the VDO policy framework be retained, to ensure that Victorians who cannot, or choose not to, engage in the electricity market can continue to access a fair and trusted price.

### Has the introduction of the VDO affected competition in the retail market?

We do not consider that the introduction of the VDO has negatively affected competition in the retail market. Instead, it may have in fact improved competitive outcomes. Despite protestation from industry that the introduction of the VDO would act as a price floor and result in the disappearance of cheaper market offers, as well as result in retailers exiting the market,<sup>4</sup> neither of these scenarios have come to pass. Instead, as noted in the Consultation Paper retailers have continued to enter the market since the introduction of the VDO and market offers priced below the VDO continue to be readily available.

Rather than serving as a floor price across the market, the VDO has instead acted as a ceiling price for people unable or unwilling to engage in the market. We consider this to result from the nature of the VDO itself, with the policy framework around the VDO designing it to be a competitive price rather than the lowest possible price available. Given the range of market offers priced below the VDO still available, we are of the view that competitive benefits have been retained for consumers willing and able to spend time searching for a cheaper market offer. Even for these consumers, we consider that the VDO has been a positive, with its introduction having resulted in market offers priced above the VDO mostly

<sup>1</sup> Clause 3, Order in Council made under Section 13 of the Electricity Industry Act 2000, No. 208 Thursday 22 May 2019

<sup>2</sup> Department of Environment, Land, Water and Planning (March 2022), *Review of the Victorian Default Offer Order in Council: Consultation Paper*, pp. 14.

<sup>3</sup> Essential Services Commission (2019), [Victorian Default Offer 2022-23: Draft decision](#)

<sup>4</sup> Australian Energy Council (2018), [Reference bills and default offers: What are the pros and cons](#)

disappearing, and by having the VDO serving as a trusted reference price which can be compared against market offers. A trusted reference price can serve to enhance competitive outcomes by making the search and switching process simpler.

In response to this question, we also suggest that during this review the team ensure that they place greater focus on consumer outcomes because of the VDO, rather than the VDO's effects on competition. The assumption inherent in deregulation of the energy market was that competition would lower prices and produce positive outcomes for Victorian energy consumers. However, experience has shown this assumption to be flawed, with competition in Victoria benefitting some consumers at the expense of others. Given this, we consider that when undertaking the review, the team must focus primarily on consumer outcomes, particularly for disengaged consumers, rather than any effects of the VDO on competition in the retail market.

### **Has the Victorian Default offer improved transparency in the retail market?**

We are of the view that the decision to make the VDO the reference point for all electricity offers, as well as complementary reforms such as the 'best offer' inclusion on customer's bills, have helped to improve transparency in the retail market. By making the VDO the reference for all market offers, consumers who are willing and able to engage in the market can more easily compare offers available to them against a consistent, trusted reference price.

While these interventions are welcome, it must also be recognised that information disclosure has its limits. It is important that these information disclosure measures do not supplement people defaulting to the VDO when they are disengaged from the market. The focus of the VDO policy framework must remain on ensuring that all people who need protection from the VDO default to it, rather than seeking to further consumer engagement in the market.

### **Has the Order covered all customer groups that should be able to access the VDO?**

The expansion of the Order to cover non-flat tariffs, terminating fixed-term contracts, as well as the ESC's decision to set the VDO as the maximum price for customers in embedded networks, have been positive steps which ensured more Victorians are able to access the VDO. Extending the VDO to cover embedded network customers was particularly important given that these people had long been subject to price gouging given their energy services were supplied through effective monopoly arrangements.

As is discussed in the Consultation Paper it is likely there is a cohort of people on legacy market offers who are paying above the VDO. Anecdotally, this is something we have heard from people calling our financial counselling service. Although we do not have data on the extent of the issue, given the tendency for customers to stick with their retailer (with the AEMC reporting in 2017 that 47 per cent of households had not switched retailers in the last five years<sup>5</sup>) there is likely to be numerous customers on legacy market offers priced above the VDO.

In line with this issue, we have pointed to those on evergreen market offers as a cohort likely to be paying too much for their energy supply in our previous VDO submissions.<sup>6</sup> As we suggested at that time, a

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<sup>5</sup> Australian Energy Market Commission (2017), [2017 AEMC Retail Energy Competition Review](#), p.4

<sup>6</sup> Consumer Action Law Centre (2019), [Victorian Default Offer for domestic and small business electricity customers: Staff working paper](#), p.14.

universal opt-out transition to the VDO for any household being charged above that price may be necessary to ensure that all Victorians who require the protection afforded by the VDO default to it. We again recommend that this universal switching mechanism be included in the VDO policy framework to ensure that all customers requiring the safeguards afforded by the VDO have access to them.

**RECOMMENDATION 1. The Order be expanded to include an opt-out switch to the VDO for any household on a legacy market offer in excess of the VDO price.**

### **What more could be done to encourage market participation by customers on higher priced market offers?**

While not seeking to discourage efforts to increase market participation by customers, the challenge of engendering consumer engagement should not be underestimated. As 2017 work by CSIRO has demonstrated, more people are disengaged from the market than those who are engaged, with the most basic driver of disengagement being that energy is a homogenous good which people tend to be concerned about only when it is not available.<sup>7</sup>

We are of the view that by and large, people do not want to engage in the market for essential services. They simply want a reliable supply of electricity, at a fair, affordable price. Furthermore, any efforts to engage people and encourage market participation add costs, not least those costs borne by consumers in the effort and time required to shop around for a better offer. We consider that rather than focusing on consumer engagement, extending the safeguard of the VDO to cover as many people as possible should be the priority focus of the review. As discussed in our response to question 4 of the Consultation Paper, implementing a universal switch to the VDO would extend this protection to customers on higher-priced market offers. Shifting the focus from encouraging market participation to widening the safety net for disengaged customers would also be more aligned with the primary objective of the VDO.

### **Does clause 12 of the Order in Council provide the ESC with an appropriate level of discretion when undertaking a VDO pricing determination?**

#### **Are there other factors that the ESC should have regard to when carrying out VDO pricing determinations?**

As currently written, we consider that clause 12 of the Order provides the ESC with appropriate discretion when undertaking a pricing determination. Overall, Consumer Action is supportive of the methodology which has been used by the ESC when setting the VDO to date. However, we are of the view that amending the Order to require the ESC to consider a productivity factor and to use the lower figure whenever working with a range of cost estimates would better ensure that the VDO price represents only the efficient price of retailing electricity in Victoria.

On the first point, the ESC suggested in 2019 that there may be merit in applying an annual 'productivity factor'. However, this has not yet been included in the price determination process to date, despite falling retail costs and productivity improvements in the energy sector. We recommend that it be included under subclause (4) as an item the ESC must consider when making a price determination. Any for-profit

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<sup>7</sup> John Gardiner and Danie Nilsson (2017), *Exploring the drivers and barriers of consumer engagement in the Victorian retail energy market*, CSIRO, p.3

business generally aims to become more efficient over time, and it is only fair that customers benefit from these efficiencies in the form of reduced prices. Introducing this productivity factor into the Order would require the ESC to have regard to it during future VDO pricing determinations but would also make clear the intention behind the VDO policy framework that retail costs should decrease over time. Including measures that will put downward pressure on prices is important as a signal to consumers that the VDO remains a fair and trusted price, as well as a signal to retailers to improve the efficiency of their operations.

**RECOMMENDATION 2. A productivity factor be included under subclause (4) as an item the ESC must consider when making a VDO price determination.**

As we have raised in our previous VDO submissions, Consumer Action accepts that the ESC must undertake a benchmarking approach to determine some elements of the cost stack, due to a combination of the absence of information, and time and effort involved in collecting information when it is available. However, we are of the view that where a benchmark approach is used it is likely to incorporate existing inefficiencies and will therefore not meet the policy objective of the VDO to ensure that disengaged consumers are paying no more than the efficient cost of providing retail electricity services.

We have previously suggested that one way to circumvent this issue is that in cases where there is a range of cost estimates available that the ESC adopt the lowest figure in any given range.<sup>8</sup> Taking this approach would be consistent with the definition of productive efficiency (supplying services/goods at lowest cost), as well as incentivising retailers to justify increased costs through the provision of data, if it is the case that a higher figure reflects actual costs.

**RECOMMENDATION 3. The Order be expanded to direct the ESC to use the lowest figure in a range of cost estimates when making price determinations, unless a higher figure can be justified through publicly available data.**

**How can the Order in Council best take account of retailers' variable expenditure on customer acquisition and retention?**

Consumer Action initially supported the Basic Service Offer (BSO) proposal coming out of the Thwaites Review. Importantly, the BSO excluded Customer Acquisition and Retention Costs (CARC). As we have previously noted in our VDO submissions,<sup>9</sup> retailer spending on CARC does not provide value for disengaged households. We consider that all households should be able to access a low price for essential services without unnecessarily covering the costs of excessive sales commissions and advertisements.

As noted in the Consultation Paper, while active consumers may benefit from competitive markets, this expenditure is of little benefit to consumers unwilling or unable to engage in the market, even though these disengaged customers are likely to bear a larger share of rising CARC. Given that expenditure on CARC offers no value for disengaged consumers, we consider that these costs are inefficient and should not be included in the VDO. This is because CARC represents an 'arms race' of retailers chasing after a

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<sup>8</sup> Consumer Action Law Centre (2019), [Victorian Default Offer to apply from 1 January 2020: Issues Paper](#), pp. 4-5.

<sup>9</sup> Consumer Action Law Centre (2021), [Victorian Default Offer 2022](#), p. 4.



fixed pool of essential services customers, without actually changing the size of the market. Allowances for CARC simply adds to this 'arms race' since the more retailers spend on attracting customers away from each other, the more they must spend to retain their existing customers, causing an escalating spiral of cost and inefficiency. We consider that the 'efficient' value for CARC is zero or close to zero (barring the small proportion of the market where retailers are providing some kind of differentiated product, such as 'green' energy).<sup>10</sup> We therefore recommend that the Order be updated to remove modest CARC as an item that the ESC must have regard to when making a VDO price determination.

**RECOMMENDATION 4. The Order be updated to remove the need for the ESC to have regard to customer acquisition and retention costs when making VDO price determinations.**

### **How does the length of the VDO regulatory period affect the operation and effectiveness of the VDO?**

We are of the view that the current 12-month period is working well but should continue to vary at the discretion of the ESC when special circumstances arise, albeit with the decision to vary the regulatory period being subject to consultation and based primarily on what will deliver the best outcomes for consumers.

As we have raised previously, we consider that there are costs and risks with making regulatory determinations too often, including the direct costs to participants in terms of time and effort invested. We agree with the current writing of the Order, which specifies that price determinations should be varied where there are uncertain or unforeseen circumstances, or where clerical errors or miscalculations have been made. We also support the wording of the current Order which specifies that whether unintended consequences require a variation must be subject to consultation.

**RECOMMENDATION 5. That the duration for each regulatory period be retained at 12 months, with the ESC able to vary the length where necessitated by unforeseen circumstances, subject to consultation.**

### **Are there ways in which the regulatory burden imposed by the VDO could be reduced without compromising achievement of the VDO policy objectives?**

We are of the view that the regulatory burden imposed by the VDO does not need to be reduced. We note that the ESC has previously raised that the VDO and other reforms have the potential to lower retailer's operating costs.<sup>11</sup>

We consider that where retailers claim regulatory changes have led to increased burden (in this case the introduction of the VDO and complementary reforms), retailers must provide detailed information on the supposed burden and any associated costs before changes can be made. This burden of proof must sit with retailers, and it should not be imposed on consumers or people and organisations advocating on their behalf.

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<sup>10</sup> We note that the 2019 ACCC Retail Electricity Pricing Inquiry said that 'it is appropriate for the regulated price to include little or no CARC' and that Independent Competition & Regulatory Commission in the ACT excludes separate allowances for CARC in its price setting decisions. See: ACCC, [REPI Final Report](#), page 248; and ICRC, Retail Electricity Prices 2020-2024, see [here](#).

<sup>11</sup> Essential Services Commission (2019), [Victorian Default Offer to apply from 1 July 2019: Draft advice](#), pp. 48-49

## **Is there anything else you would like to raise about the operation of the Order in Council?**

We consider that it is necessary to expand the Order to introduce a VDO for gas as a matter of priority. As we transition away from gas it is essential that the Victorian Government immediately implement a default offer for gas to ensure prices remain affordable and fair, particularly for consumers on fixed incomes or experiencing vulnerability. We have previously highlighted that different rules for electricity and gas will cause confusion in the market and undermine consumer trust. It is also the case that where low income and vulnerable households are unable to shift from reliance on gas as a fuel source they risk being stranded and left to pay increasingly higher costs for their energy supply.

Recent research from St Vincent de Paul demonstrates that Victorians who do not or cannot switch are being exploited through high standing gas prices.<sup>12</sup> Typical consumption households on a standing offer can be charged between \$920 and \$1,065 per annum more (depending on their location) than if they were on the best offer. Furthermore, in January 2022, households with Origin Energy and AGL experienced price increases of 16 percent (average across all areas) and 7 percent (depending on location) respectively.

A particular problem is that retailers continue to misleadingly advertise 'discounts' when they are discounting from a price they each set, rather than a reference price that aids comparability. A VDO for gas would help address this.

Hardship data also tells us that many Victorians are struggling with gas bills. Data from the Essential Services Commission for December 2021<sup>13</sup> reported more than 207,000 Victorian residential households had arrears on their bills, with an average of \$491 outstanding for each affected customer. On top of this, almost 48,000 households were receiving bill assistance from their retailer. Small business customers are also affected, with some 12,000 in arrears, with an average of \$1,061 each. There were more than 300 Victorians who were disconnected from their gas supply in January 2022.

Introducing a VDO for gas would safeguard households who are unable or unwilling to engage with the gas retail market and bring gas pricing regulation into line with the VDO for electricity. Furthermore, making consumer protections consistent across fuel types will aid in consumer awareness and understanding of the VDO. As gas prices increase, introducing a gas VDO would also allow it to be used as a reference price so that people could compare offers to understand whether they are paying a fair and reasonable for their gas service.

**RECOMMENDATION 6. The Order be expanded to introduce a VDO for gas as a matter of priority.**

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<sup>12</sup> St Vincent De Paul, Victorian Energy Prices, January 2022, available at: [https://www.vinnies.org.au/page/Our\\_Impact/Incomes\\_Support\\_Cost\\_of\\_Living/Energy/VIC/](https://www.vinnies.org.au/page/Our_Impact/Incomes_Support_Cost_of_Living/Energy/VIC/)

<sup>13</sup> Essential Services Commission (2022) [Victorian Energy Market Report](#)



Please contact **Luke Lovell** at **Consumer Action Law Centre** on 03 9670 5088 or at [luke@consumeraction.org.au](mailto:luke@consumeraction.org.au) if you have any questions about this submission.

Yours Sincerely,

**CONSUMER ACTION LAW CENTRE**

A handwritten signature in black ink that reads "Gerard Brody". The signature is written in a cursive, flowing style.

**Gerard Brody** | Chief Executive Officer

