

14 December 2023

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

Dear Commissioners,

2024-25 Victorian Default Offer: Request for Comment paper

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Essential Services Commission's (ESC) Request for Comment paper for the 2024-25 Victorian Default Offer (VDO).

Consumer Action reaffirms the importance of the policy intent underpinning the VDO to provide a simple, trusted and reasonably priced electricity option that safeguards consumers who are unwilling or unable to engage in the market, alongside the broader objective of the ESC in promoting the long-term interests of Victorian consumers. To date, we believe the VDO has predominantly delivered in its overall objective.

In this submission, we provide specific insights and recommendations with reference to the methodology of the VDO as requested by the ESC in their paper, namely on approaches to calculating wholesale electricity costs and retail operating margin. In addition to our comments on these matters, we also provide comment on the ongoing cost of living crisis and the health impacts of extreme weather, and the resulting critical priority for Victorian consumers to have access to affordable electricity offers. More detailed comments in relation to these points are provided below.

Alongside this submission, Consumer Action supports and co-signs the community sector joint paper submitted by VCOSS which highlights additional areas that the ESC should consider when deciding the 2024-2025 VDO.

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.

Wholesale electricity costs

In previous VDO consultations, we have recommended that the ESC retains the use of trade-weighted futures contract prices to benchmark wholesale electricity costs. We continue to be of the view that the ESC must investigate how it can incorporate a wider range of risk-management strategies available to retailers into their wholesale cost estimates to ensure they reflect efficient costs. However, we agree with the ESC that using ASX futures provides a reasonable proxy in the meantime. Importantly, futures contract prices on ASX Energy are more transparent than alternative approaches being discussed, namely over the counter contracts, where information about prices and volumes linked to these contract types are not publicly available.

We note that the Australian Competition and Consumer Commission (ACCC) identified in November 2022 that retailers were shifting towards trading contracts over the counter as part of their ongoing Inquiry into the National Electricity Market (NEM)¹. We also note that this analysis was based on data from January 2021 to September 2022, and have not seen more recent data to be able to identify whether this reflects current contracting arrangements. Given this, we recommend that the ESC continues to retain the use of trade-weighted futures contracts to estimate wholesale prices for the 2024-25 VDO. It is our view that the ESC should continue to use the benchmark currently in place for the purpose of the 2024-25 VDO, unless retailers can provide evidence that they are making material use of different instruments to manage peak price risk, and that this represents a sustained shift in contracting arrangements.

RECOMMENDATION 1. Retain the use of trade-weighted futures contract prices to estimate wholesale prices for the 2024-25 VDO.

Retail operating margin

We welcome the ESC's decision to seek suggestions on potential alternative approaches for setting the retail margin ahead of the decision on the 2024-25 VDO. Given current cost of living pressures impacting Victorians including increased energy prices, it is critical that retail margins are justifiable.

While acknowledging the time pressures which led to the ESC using a benchmarking approach to set the retail margin for the initial VDO, we repeat our previous recommendation that the ESC should now undertake to commission bottom-up modelling to calculate what an efficient retail margin is. As the ESC itself has noted in this Request for Comment paper, stakeholders (including ourselves) have raised the risk of circularity if regulators continue to use benchmarks set by other regulators. Relying on other regulators' historic decision-making, which may rely on other prior decisions, could simply perpetuate inefficiencies contained in prior determinations. By commissioning new modelling, the ESC will be able to identify an efficient margin, based on up-to-date, independent evidence.

Available evidence also suggests that the current benchmark may be generous and is out of step with current retailer margins. To this end, we note firstly the review of margins undertaken by the ESC in 2021, which revealed that the margin set by the ESC was at the top of the of the range when compared to other Australian jurisdictions. Furthermore, we call attention to the ACCC's exploration of retailer margins in November 2022, as part of their Inquiry into the NEM. In this report the ACCC identifies that retail margins have been on a downward trend over recent years, noting that, "...the average retail margin across the National Electricity Market had dropped to \$35 per residential customer in 2021–22, a decrease of 33% in real terms from the previous financial year. This decline continues the general downward trend in retail margins from their peak in 2016–17"². Taken together, we consider

¹ Australian Competition and Consumer Commission, [Inquiry into the National Electricity Market – November 2022 Report](#).

² Ibid, p. 72.

that this evidence suggests that there may be room to further decrease the retail margin in the VDO, and that the ESC should commission bottom-up modelling to identify what an updated efficient retail margin would be.

RECOMMENDATION 2. The ESC commissions bottom-up modelling to quantify an efficient retail margin.

Removing Customer Acquisition and Retention Costs

In addition to providing suggestions in alternative approaches to the Retail Operating margin, Consumer Action supports the consumer sector call that the customer acquisition and retention costs (CARC) should be removed from retail operating costs. Victorian consumers receiving the VDO are, by definition, not receiving a market offer and therefore shouldn't bear the associated costs of marketing, retaining and acquiring customers. Retailers' costs of marketing and acquiring customers is arguably not a relevant cost to the VDO, yet is a cost added by retailers to Victorian consumers' energy bills. Consumer Action notes that while the ESC does not have independent power to remove this portion of the Retail Operating cost, we support the sector's recommendation that the ESC urges the Minister to do so.

RECOMMENDATION 3. The ESC provides Ministerial advice to remove customer acquisition and retention costs from the Retail Operating Cost of the VDO.

Cost of living & environmental considerations

We reaffirm the important purpose of the ESC to promote the long-term interests of Victorian consumers with respect to price, quality and reliability of essential services, as well as the requirement to consider the effect on consumers experiencing vulnerability in delivering on this purpose. With this in mind, we recommend that the ESC considers the current financial pressures consumers are navigating when selecting their final methodology for the 2024-25 VDO and making the Draft Decision.

The ESC's Victorian Market Energy Report 2022-2023 notes both a continued increase in consumers needing to access assistance with their electricity costs and a reduction in consumers ending tailored assistance, indicative of the difficulty large numbers of people are facing in paying their energy bills³. This growing cohort of people experiencing payment difficulty evidences the ongoing need for downward pressure on energy costs as part of addressing longer-term financial hardship. In line with this, and consistent with the purpose of the ESC to promote the long-term interests of Victorian consumers, it is our view the ESC should carefully consider both the current high rates of energy hardship in Victoria, as well as the 25% increase in the VDO for 2022-2023 and its continued impacts on consumers, when finalising the methodology and calculating the VDO for 2024-25.

Throughout 2023, financial counsellors on the National Debt Helpline in Victoria identified energy debt as remaining in the top three areas of financial difficulty for callers. Of these callers, Consumer Action found that 52% had an average energy debt of over \$2,200 - more than 220% of callers' average fortnightly income. While Victorian energy relief schemes provide crucial assistance, they are not keeping up with growing energy debt. Without additional measures to ensure affordable energy prices, Victorian consumers will fall into further dangerous levels of debt.

Additionally, as extreme weather continues to increase, evidence points to heatwaves as one of the leading causes of death in Australia⁴. In this climate, access to an affordable energy supply grows in importance. In addition to

³ Essential Services Commission [Victorian Energy Market Report | Essential Services Commission](#) November 2023

⁴ Risk Frontiers [Heatwave fatalities in Australia: a new analysis](#) December 2021

energy services being measured against consumer benefit, they are an increasingly crucial aspect of ensuring safe and liveable homes for all Victorians, in maintaining a healthy and comfortable living environment.

With regard to the VDO's impacts in the economic environment, the effects of the VDO in the broader energy market may have influence on retailers' prices, and so increases to the VDO must be considered as a potential secondary impact on many more consumers who are on market offers.

We recommend that the ESC carefully considers the impacts and risks Victorian consumers currently face from both cost of living pressures and extreme weather events in all its decision-making around the 2024-25 VDO. An increase to the VDO would exacerbate these impacts. The potential health, safety and social risks to consumers as a potential consequence of increasing electricity prices must be taken into account.

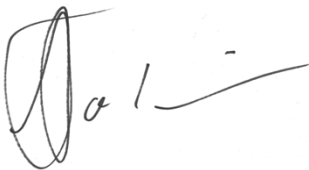
One avenue for the ESC to achieve this is by selecting from the lower end of a range wherever a range of costs is being calculated for the 2024-25 VDO.

RECOMMENDATION 4. For the ESC to account for the broader health, safety and social risks to consumers as a result of increased energy prices by selecting a figure from the lower end of a range of costs when they are calculating the cost stack for the 2024-25 VDO

Thank you again for the opportunity to provide comment. Please contact Policy Officer Eirene Tsolidis Noyce at **Consumer Action Law Centre** on 03 9670 5088 or at eirene@consumeraction.org.au if you have any questions about this submission.

Yours Sincerely,

CONSUMER ACTION LAW CENTRE



Stephanie Tonkin | Chief Executive