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08 April 2022

Submitted via Engage Victoria

Commissioners

Essential Services Commission

Level 37, 2 Lonsdale Street

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Dear Commissioners,

Victorian Default Offer 2022-23

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Essential Services Commission's (the **ESC**) Draft Decision for Victorian Default Offer (the **VDO**) tariffs to apply for the period 1 July 2022 to 30 June 2023 (the **draft decision**).

We note that the ESC has essentially used the same approach in this draft decision as they did in their 1 January 2022 VDO price determination. Given our overall support for the 2022 VDO price determination,[1] we are also largely supportive of the 2022-23 draft decision. However, we question the timing of the changed methodology that has resulted in higher wholesale costs in this decision, particularly when savings from cheaper wholesale prices remain to be passed on to households.

Furthermore, in line with previous submissions we urge the ESC to review benchmark charges to households for retail operations, consumer acquisition and retention costs and retail margins, to ensure that the VDO continues to meet the objective of providing, "… a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity market."[2] That the VDO remain a 'reasonably priced electricity option' is particularly pressing at this time, coming amidst escalating cost of living pressures and the challenges of post-pandemic recovery. While the one percent cost rise in this determination is small, for consumers in financial difficulty any price rise is significant. It is therefore important that benchmarks are subject to ongoing interrogation to ensure costs reflect efficient retail operations.

More detailed comments on these points, as well as other aspects of the draft decision, 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

[1] Consumer Action Law Centre (2021), Victorian Default Offer 2022
[2] Essential Services Commission (2022), Victorian Default Offer 2022-23: Draft decision, 15 March, p.2

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

Wholesale prices

As with our comments on previous decisions, we are supportive of the ESC's approach to use a 12-month period to calculate wholesale costs for the 2022-23 VDO, as this maintains consistency with past reviews and reflects the reality of retailer hedging behaviour.

While we acknowledge the point in the draft decision as to the changed pattern of demand due to the growth of rooftop solar, and the impact this may have on wholesale prices, we question the fairness of forecast increases to wholesale costs being passed on to consumers in this VDO determination given that falling wholesale costs in previous decisions may have not yet fully flowed through to households. In their most recent electricity market report from December 2021, the Australian Competition & Consumer Commission (**ACCC**) noted that while cheaper wholesale prices have reduced the cost to supply electricity, there remains further savings to be passed on households.[3] Our submission to the 2022 VDO variation noted analysis by the Victorian Energy Policy Centre which concluded that first and second tier "retailers are passing through less than half of the wholesale price variation in their retail offers".[4] In that submission, we noted the importance of the ESC ensuring lower wholesale prices flow through to consumers. We reiterate this point, noting the need to ensure that previous wholesale price decreases have fully flowed through to consumers before they can be expected to wear the cost of predicted future cost rises. This is particularly pressing given rising cost of living pressures people are facing. As one of the larger household expenses, minimising rises in electricity prices will make a significant contribution to easing financial stress for households, particularly where people are on low or fixed incomes. There is also the related issue of maintaining trust in the VDO. Ensuring that cost decreases, as well as increases, are fairly reflected in VDO price determinations is essential to maintaining trust.

We also reiterate our previous position[5] that the ESC's overall approach to estimating wholesales costs is conservative and should be treated as an upper bound, rather than the efficient cost of providing retail electricity services. We recommend that the ESC incorporate the full range of risk-management strategies available to retailers into their wholesale cost estimates to ensure these represent an efficient cost.

RECOMMENDATION 1. The ESC delay changes to wholesale cost methodology until consumers have received the full benefit of previous price decreases.

RECOMMENDATION 2. The ESC review its approach to estimating wholesale price benchmarks to ensure they align with actual costs faced by retailers.

Environmental costs

We are concerned that environmental costs have increased again in this draft decision due to further cost increases associated with the Victorian Energy Upgrades Program (**VEU**). While we support the program's intent to improve energy efficiency of Victorian households, it is important that consumers are not burdened with bill increases through no fault of their own.

In line with the above point, we support the ESC's decision to use the same approach and continue to use a 12-month weighted average to forecast certificate prices. We also agree with the ESC's decision to reject retailers

[3] Australian Competition and Consumer Commission (2021), Inquiry into the National Electricity Market: November 2021 Report, p. 6
[4] Kelly Burns and Bruce Mountain (2021), Do wholesale electricity prices pass-through to consumers in contestable retail electricity markets? An examination in Victoria, Australia, VEPC Working Paper WP2108, p.27
[5] See: Consumer Action Law Centre (2020), Victorian Default Offer 2021 – Consultation Paper, pp. 4-6

request for an adjustment to VEU certificate prices. Consumers should not be expected to cover the cost of factors related to the pandemic, or a decrease in the availability of sites for simpler certificate activities.

Retail operating costs

We also repeat our past calls to lower the benchmark for retail operation costs, as we consider that there remains a number of components in the calculation of retail operating costs that would benefit from review.

As we have previously raised,[6] we consider that the ESC should go back to its draft advice to government for the VDO prices to apply from 1 July 2019, which used an average operating cost of $96.66 per customer (plus adjustments), taken from the ACCC's Retail Electricity Price Inquiry. We are of the view that this represents a more comprehensive and reliable assessment of retailer costs when compared to the ACT Independent Competition and Regulatory Commission's (the **ICRC**) 2017 decision which is currently in use. This latter benchmark price itself relied on benchmarks from other regulators, with the circularity of this approach exposing consumers to paying for inefficient costs which may be included in this figure.

We support the ESC's position on page 22 of the draft decision that where retailers claim regulatory changes have led to increased costs (in this case the introduction of commitments made under the Victorian Energy Fairness Plan*)*, that retailers should provide detailed information on the associated costs before changes to the benchmark can be made. We consider that the burden of proof should sit with retailers to provide robust evidence demonstrating why a higher figure should be used before any change in the benchmark can be considered. Related to this point of regulatory costs, we note that the ESC has previously raised that the VDO and other reforms have the potential to lower retailer's operating costs.[7] We agree with this position and recommend that the ESC request evidence from retailers to understand whether recent reforms have increased efficiencies for retail businesses and adjust the benchmark accordingly if this is found to be the case. This should also include review of whether compliance costs added to cover Victoria-specific regulation are still justified.

RECOMMENDATION 3. That the ESC set the benchmark for retail operating costs at the average amounts reported by the ACCC Retail Electricity Pricing Inquiry for 2017-18.

RECOMMENDATION 4. The ESC review retailer operating costs to identify any efficiencies resulting from the introduction of recent reforms in Victoria and adjust the benchmark as required.

We strongly support the ESC's decision to remove the temporary adjustment for bad debts from the cost stack. As a general principle we are of the position that consumers should not bear the costs of wholesale market risk, including cost impacts resulting from the pandemic. We also agree with the ESC's approach to consider broader economic and financial indicators in arriving at this decision. Like the ESC, we are of the view that this is approach is preferable to using a single measure (in this case 90 day plus debt levels).

As mentioned in our previous VDO submissions, it is our view that customer acquisition and retention costs (**CARC**) are inefficient and should not be included in the VDO. However, given that the Order in Council requires a 'modest' allowance for CARC we recommend that the ESC should take a bottom-up approach to recalculate the CARC benchmark, in order to identify the actual costs of a 'modest' CARC.

We also note the recent reforms under the Victorian Energy Fairness Plan banning energy retailers from engaging in unsolicited selling and offering 'save' and 'win back' offers. To ensure that the benchmark reflects 'modest' CARC we recommend that the ESC calculate the estimated costs associated with these sales practices and remove them from the CARC benchmark used in VDO determinations. This type of downward pressure on prices is important to

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[6] Consumer Action Law Centre (2019), [Victorian Default Offer to apply from 1 January 2020: Draft decision](), p. 8
[7] Essential Services Commission (2019), [Victorian Default Offer to apply from 1 July 2019: Draft advice](), pp. 48-49

ensure the VDO remains a fair and trusted price, as well as a signal to retailers to improve the efficiency of their spending on customer acquisition and retention, and to avoid the excessive spending we have seen in the past.

RECOMMENDATION 5. The ESC recalculate the CARC benchmark using a bottom-up approach, to identify the actual costs of 'modest' CARC.

RECOMMENDATION 6. The ESC reduces the CARC benchmark through removal of estimated costs associated with unsolicited sales, and 'save' and 'win-back' offers.

Retail margin

We also consider that it is necessary to review retail margins to ensure these are justifiable. While acknowledging the time pressures which led to the ESC using a benchmarking approach to set retail margin for the initial VDO, we believe that the ESC should now undertake to commission bottom-up modelling to calculate what is an efficient retail margin.

Despite protestation from industry that the introduction of the VDO would harm competition and lead to retailers exiting the market, instead new retailers continue to enter, and market offers priced below the VDO are widely available. The review of margins undertaken by the ESC in 2021[8] also revealed that the margin set by the Commission – 5.7 per cent – was equal to the 2018-19 average margin reported by retailers, and at the top of the of the range when compared to other Australian jurisdictions. This suggests that there may be room to further decrease the retail margin in the VDO, especially given productivity improvements in the sector since the VDO was introduced.

We also reiterate the point we made previously, as to the risk of circularity inherent in the benchmarking approach. Relying on other regulators' historic decision-making, which may rely on other prior decisions, may 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.

RECOMMENDATION 7. The ESC commission bottom-up modelling regarding efficient retailer margins and set the margin at the low end of any range given.

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

Yours Sincerely,

CONSUMER ACTION LAW CENTRE

Luke Lovell | Policy Officer

[8] Essential Services Commission (2021), Next steps for the Victorian Default Offer: Consultation on our approach to network tariff reforms and determination process, pp. 17-19