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Victorian Default Offer
Essential Services Commission

Dear Essential Services Commission,

Victorian Default Offer 2025-26 Request for comment

We welcome the opportunity to provide our submission to the Essential Services Commission (**ESC**) on the Victorian Default Offer (**VDO**) 2025-26 Request for comment paper.

We support the purpose of the VDO in providing a safeguard for consumers who may be unable or unwilling to engage in the energy market. We provide our insights drawn from Consumer Action's financial counselling services, to highlight the experiences of Victorians contacting the National Debt Helpline (**NDH**).

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.

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Overview

The cost-of-living crisis has deepened the urgency of ensuring an affordable energy price for Victorians. On Consumer Action's frontlines, we hear from Victorians every day who are struggling to meet their basic costs of essentials.

Ensuring the VDO continues to meet the objective of providing a simple, trusted and reasonably priced electricity option is of increasing importance as Victorians continue to face the impacts of the cost of living crisis, as well as the costs of the transition to renewable energy. Low-income households, renters and people experiencing vulnerability are more likely to face additional challenges in the cost of living crisis, and the transition to renewables adds another layer of complexity. These households face barriers to modifying energy usage, lack of autonomy and resources to make energy efficient changes to their home to bring down rising energy costs[1]. Consequently, people in these circumstances are more likely left with no choice but to rely on gas supply, with higher gas prices, in addition to the risk of increasing electricity costs. In this context, it is crucial that the VDO ensures an affordable electricity price is available for low-income Victorians.

While supportive of the purpose of the VDO, we note that increasing energy prices in the wider market[2] continue to have significant impacts on Victorians in energy hardship who are contacting the NDH for assistance. As we discuss further below, we are seeing a sustained, significant increase in the number of people contacting our financial counsellors for assistance with energy hardship. Due to the harms Victorians are facing as a result of widening and deepening energy poverty, we provide an additional recommendation to address this growing problem via introduction of a social tariff. We acknowledge consideration of a social tariff may be beyond the scope of this consultation, however it is the big picture of energy pricing and hardship in Victoria. We are observing protracted energy hardship on our frontlines and this underlines the need to seriously engage with designing a social tariff to ensure that low-income Victorians can afford an essential energy service.

Insights from the National Debt Helpline

Who is contacting the NDH in energy hardship

Victorians contacting the NDH regarding their energy bills are significantly more likely to be receiving a Centrelink income, with 63% of people recorded receiving a Centrelink income in 2023.

In addition to low-incomes, the majority of people struggling with the cost of electricity are renting the home they live in (54%) and are often living in single families (22%).

We note these demographic and financial circumstances of our clients as they provide insights into the lived experience of people dealing with energy hardship, and as such should be considered by the ESC when developing the VDO for 2025-26.

Electricity in the cost of living crisis

According to national NDH data, in the two months from January to February of 2023 there was 50% increase in Victorian callers to the NDH when compared to the same period in 2022[3].

Consumer Action's financial counsellors on the NDH have also noted the increased financial strain experienced by Victorians contacting our frontline services, particularly regarding their electricity bills. In our submission to the Senate Select Committee on the Cost of Living, we highlighted that electricity bills were the third most commonly

[1] Australian Energy Regulator, *State of the Energy Market 2024 – Retail energy markets* November 2024, p.261
[2] *'In electricity markets, electricity bills for customers increased in all regions in 2023-24'* Australian Energy Regulator, *State of the Energy Market 2024 – Retail energy markets* November 2024, p.250
[3] Consumer Action, *REPORT: At the front line of the cost-of-living crisis - Consumer Action Law Centre* March 2024, p.10

occurring type of financial difficulty flagged by our financial counsellors in 2023. Our financial counsellors hear from Victorians contacting the NDH that they are prioritising paying their electricity bills, yet as a result often struggle with other essential costs - over 70% of people presenting to the NDH with energy affordability issues also reported at least one other debt or payment difficulty type[4].

Energy debt

As noted in the Victorian Energy Market Report, more Victorians are experiencing financial stresswith an increase of 20,000 Victorian electricity customers owing their retailer at least $300 in 2023-24 compared to 2022-23[5]. This growing trend of hardship is also being experienced across National Energy Market (**NEM**) jurisdictions, with the Australian Energy Regulator (**AER**) in 2022-23 recording the lowest levels of Australians exiting hardship programs by clearing their debt since 2018-19[6].

Consumer Action's fourth edition of the *Energy Assistance Report* released in June 2024, painted a similar picture of growing energy hardship. In it we recorded the highest average electricity debt; the largest number of annual contacts to the NDH by people in energy debt; and the highest number of people with an energy debt over $3,000. Growing numbers of Victorians are also trying to deal with historical debt – 18% of people had a closed energy account debt - up from 8.5% in 2022[7].

While the above figures relate only to the 2023 calendar year, they are indicative of a longer-term trend. In the last three years, the average electricity debt recorded on the Victorian NDH has increased by 27%, with an average debt of $2,048 in 2023, in comparison to the 2019-2020 average debt of $1,6118[8]. With regard to people's ability to repay debts, we found that the average energy debt ($2,048) represented 253% of the average fortnightly income ($1,035) of Victorians contacting the NDH to discuss energy debt.

After factoring in the prevalence of multiple debts, and increasing costs such as electricity and housing payments, we consider that the majority of people contacting the NDH in energy hardship don't have the capacity to repay their debt, and afford ongoing usage costs.

1. Do you support the Victorian Default Offer estimating retail operating costs separately for domestic and small-business customers?

We support the proposal to separately estimate retail operating costs for domestic (or residential) customers and small-business customers, with the condition that safeguards are put in place to ensure that residential consumers are protected from increased cost estimates.

Comparative energy costs for residential and small business customers

In their Inquiry into the National Electricity Market June report, the Australian Competition and Consumer Commission (**ACCC**) recorded that Victorian small business customers experienced the biggest decrease in effective prices, at 20% in quarter 3 of 2023, compared to Victorian residential customers experiencing a 10% increase in the same period[9].

Residential and small business consumers clearly have different energy usage patterns, needs and circumstances. However, we are concerned that residential consumers may face increased prices due to retailers apportioning

[4] Consumer Action, *Submission Select Committee on Cost of Living - Consumer Action Law Centre* March 2024, p. 3
[5] Essential Services Commission, Victorian Energy Market Report | Essential Services Commission November, 2024, p.6
[6] In AER's NEM jurisdictions as recorded in their Annual retail markets report 2022-23 Retail data shows continued support needed for energy consumers | Australian Energy Regulator (AER)
[7] Consumer Action Law Centre, *Keeping the Lights On – Energy Assistance Report*, June 2024
[8] Consumer Action, REPORT Energy Assistance Report 4th Edition: Keeping the Lights On - Consumer Action Law Centre, June 2024, p.14
[9] Australian Competition and Consumer Commission, Inquiry into the National Electricity Market - June 2024 report, June 2024, pp.28-29

higher costs to serve residential consumers, which simply builds in existing inefficiencies or overlooks the impact of these costs on consumers receiving the VDO. For this reason, we are supportive of the proposal to separate cost estimates for residential and small business customers only on the condition that consumers are safeguarded from the risk of increased costs.

As demonstrated in the request for comment paper, the proportion of retail operating costs is significiantly higher for residential customers than small business[10]. Given that the estimate also includes costs associated with bad and doubtful debt,we are concerned that the current trend of consumers exiting payment difficulty assistance without resolving arrears, and the risk of increasing energy prices will entrench higher retail operating costs in the cost stack for residential customers, without resolving the underlying issue of energy unaffordability for Victorians.

We recommend that the ESC set this safeguard for residential customers by adopting a cap that sets a reasonable maximum proportion of retail operating costs in the VDO for residential customers.

<u>Bad and doubtful debts in Retail Operating Costs</u>

This year's Victorian Energy Market Report highlighted the increased financial stress experienced by consumers, shown in the increased number of people exiting assistance due to being unable to meet their payment plan. Further, the ESC outlines that the high average arrears reported by retailers may indicate some retailers need to improve support to their customers in energy debt[11]. We support the ESC's commitment noted in its report to gather further information on retailers' practices regarding energy debt. This information gathering would also assist infurther analysing retailers' approach to payment difficulty assistance as compared to debt collection in retailers' operating costs.

Retailers' approach to payment difficulty assistance has a direct correlation to the amount of bad and doubtful debts incorporated in retailers operating costs, including the additional administrative costs associated with attempts to collect the debt. For Victorians in energy debt or low incomes on the VDO, they are effectively paying twice for a debt they are unlikely to be able to pay off.

With the above issues identified in relation to retail operating costs, we strongly recommend the ESC sets a limit on the proportion of retail operating costs within the VDO, including for bad and doubtful debts for a residential customer estimate, and selecting from the lowest range for the VDO 2025-26.

RECOMMENDATION 1. If separating domestic and small business estimates of retail operating costs, the ESC should safeguard domestic customers from price increases by adopting a cap on retail operating costs in the VDO

RECOMMENDATION 2. The ESC set a low maximum limit on the estimate of retail operating costs in the VDO for domestic customers

<u>Customer Acquisition and Retention Costs</u>

As we have stated in previous submissions, people receiving the VDO are by virtue of being on the default offer, either not willing or able to engage in the market. For this cohort, customer acquisition and retention costs (**CARC**) should not be factored in to a default offer, given that customers not engaged in the market receive no benefit from this expenditure.

[10] Essential Services Commission, *2025-26 Victorian Default Offer: Request for Comment*, November 2024, p.6
[11] Essential Services Commission, Victorian Energy Market Report: Annual 2024, November 2024, p.10

Even for the broader market of 'engaged' consumers, it appears that retailer expenditure on CARC offers customers little to no value (if the metric applied is achieving a saving on bills by finding a low-cost market offer).

From a sample drawn from 5 million residential customers in August 2023, the ACCC found that 47% of customers were on plans equal or higher than the default offer (assuming that conditional discounts were met 100% of the time). For concession customers, this number was only slightly better at 42%[12]. We question the veracity of techniques being applied by retailers to acquire and retain customers, when such a significant proportion are stuck on a price at or higher than the default.

RECOMMENDATION 3. For CARC to be removed from estimates of retail operating costs for domestic customers

2. What are your views on the appropriateness of the current retail operating margin and where should it sit within the feasible range?

The retail operating margin represents the the amount required to compensate investors for the capital they provide to retailers[13]. In the 2022-2023 financial year, the three largest energy retailers recorded a combined profit of more than $1.64 billion[14], despite facing higher network costs in the same year. In the previous financial year, corporate profits were the highest on record in Australian history[15]. These increases in retailer profits appear more than adequate to compensate investors.

In a recent discussion paper calculating retail costs for two large retailers, The Australia Institute found evidence that electricity costs for residential consumers were significantly higher than for business, concluding that consumers are heavily subsidising business, and that more than a third of the price consumers are paying for electricity comprises retail profit before interest and tax[16].

We acknowledge that this paper models these calculations on retail market offers, which are separate to the VDO. However, we reference the paper with the view that the VDO's purpose is in part to set a reference price for the electricitiy market, and consequently it should be playing a more proactive role in putting downward pressure on market offers in the interest of consumers, rather than reflecting the retailers in their regard to a retail operating margin for their retail market offers.

We recommend the ESC reduce the retail operating margin to the lowest quadrant of the range outlined by the Independent Competition and Regulatory Commission (**ICRC**). We submit that choosing a lower point in the range would reflect increased competition, better reflect the costs of an efficient retailer given the current likelihood of inflated profit margins in the market, and would support the objective of protecting the long-term interests of consumers who are facing significant risks to their health and well-being due to increased costs of essentials, including electricity.

It would be to Victorian consumers' long-term interests for the ESC and ACCC to investigate retailers' practices in their calculations of retail operating margins, particularly regarding the proportion of profit before interest and tax, with regard to their retail market offers. An investigation could utilise the VDO and DMO as a reference price in order to compare how the VDO is being used by retailers as a reference with regard to retail operating margins.

[12] Australian Competition and Consumer Commission, *Inquiry into the National Electricity Market, December Report*, December 2023, p.53
[13] Essential Services Commission, *2025-26 Victorian Default Offer: Request for comment paper,* November 2024, p.8
[14] Origin Energy reports $1 billion profit amid cost of living crisis | SBS News
[15] Prof. Allan Fels AO, Inquiry into Price Gouging Report to the ACTU, Final Report, February 2024, p. 7
[16] David Richardson, The Australia Institute *Price Gouging: AGL and Origin Are you being ripped off?* Discussion paper, December 2024, pp.4-7

RECOMMENDATION 4. For the ESC to select a lowest feasible retail operating margin for the VDO 2025-26

3. Are there any other considerations we should have in determining a retail operating margin for an efficient electricity retailer?

Systemic risks

The retail operating margin includes non-diversifiable risk. We acknowledge that there are considerable systemic risks associated with the energy market, and highlight the effects of these risks on consumers in the sections below.

Economic and health risks

The recent price hikes that have washed through the market and have driven increases in energy hardship exemplify the economic aspects of systemic risk. As the AER notes, energy price increases can place significant strain on low-income households[17].

The inability to afford to use energy has been shown to have significant impacts and risks on consumers, with a recent study finding that increasing energy prices can lead to people cutting back on food expenses in lieu of their energy costs[18], resulting in an 'energy or food trade-off'.

There is mounting research on the interrelation between energy affordability and health impacts, including risks to life such as heat-related deaths, with one survey undertaken by academics at RMIT University finding 89% of respondents being reluctant to use air-conditioning due to electricity costs[19]. We submit that it is unacceptable for consumers to wear these risks in respect to the provision of an essential service.

Environmental risk

In addition to the above risks faced by consumers, the rapidly increasing effects of climate change are one of the most prominent threats facing humanity[20]. In the energy market, this will include risks to network reliability due to force majeure events, which carry significant and life-threatening risks to consumers.

With all of the above in mind, when considering the retail operating margin and the return to shareholders, we recommended that the ESC must also consider the the risks to consumers when determining the retail operating margin for an efficient retailer.As our energy usage and our climate continues to change, the long-term interests of consumers to have access to reliable and affordable sources of energy will remain paramount. The systemic risks to consumers associated with this changing landscape must be taken into account, and balanced by limiting operating margins, to limit increased costs to use energy. In our view, the consumer currently holds too much risk exposure, and instead this non-diversifiable risk should be better reflected in retail margins for the 2025-26 VDO.

RECOMMENDATION 5. For the ESC to consider the systemic risks consumers face when determining retail margin.

[17] Australian Energy Regulator, *State of the energy Market 2024,* November 2024, p.259
[18] Jane M. Fry, Lisa Farrell, Jeromey B. Temple, *Energy poverty and food insecurity: Is there an energy or food trade-off among low-income Australians?*, Energy Economics, Volume 123, 2023, https://www.sciencedirect.com/science/article/pii/S0140988323002293
[19] Nicholls L., McCann H., Strengers Y. & Bosomworth K. 2017. *Heatwaves, Homes & Health: Why household vulnerability to extreme heat is an electricity policy issue*, Centre for Urban Research, RMIT University, Melbourne. pp.4-5
[20] Hui-Min LI, Xue-Chun WANG, Xiao-Fan ZHAO, Ye QI, *Understanding systemic risk induced by climate change*, Advances in Climate Change Research, Volume 12, Issue 3, 2021, https://www.sciencedirect.com/science/article/pii/S1674927821000782 Section 4

4. Is there a better approach to estimating Victorian Energy Efficiency Certificate prices?

With regard to environmental costs, we support the ESC receiving additional data from retailers on their approach to the costs of Victorian Energy Efficiency Certificate (**VEEC**) prices, which would support the ESC's objectives in ensuring a transparent and replicable VDO price, as well as delivering a potential saving for consumers.

We submit that when accounting for environmental costs of the transition to renewables, the ESC must have regard to the risk that certain cohorts of Victorians are less able to access or afford to transition to renewable energy, yet may still be paying costs associated with the transition. As one example, dual-fuel consumers unable to electrify may dealing with increased gas prices, while also having to pay for VEEC and wholesale solar export costs.

Low-income Victorians and renters face barriers to electrify their homes, both for financial reasons associated with the up-front costs of upgrades such as solar panels, and in the case of renters, limitations to their ability to make changes to their home. We acknowledge that the costs to transition to renewables must be distributed across the energy market, however we recommend that the ESC further consider how these costs impact low-income consumers and people experiencing vulnerability in order to ensure costs are distributed on a fairer basis.

RECOMMENDATION 6. For the ESC to consider the impacts of higher VEEC prices in the VDO for low-income consumers, and consumers experiencing vulnerability, when determing environmental costs

5. Low-income social tariff

In addition to our responses to the select matters raised in the paper, we also submit consideration of a social tariff as an alternative methodology that could address the issues we have identified, and support the long-term interests of consumers facing vulnerability, who are at highest risk of experiencing harms caused by unaffordable electricity costs.

As identified above, low-income Victorians are at higher risks to their health and well-being as a result of increased energy prices. We acknowledge that the VDO serves as a reference price for the current retail market, and we support its objectives to this end. This said, we consider that the VDO could provide a transparent cost-stack that could be used in the establishment of a social-tariff for low-income Victorians.

We propose that the ESC consult with the Victorian Government and the Department of Energy, Environment and Climate Action (**DEECA)** to investigate developing a low-cost, targeted tariff for low-income Victorians. This tariff would utilise the costs contained in the VDO stack as a reference for the cost types to be considered, with cost inclusions and estimates assessed based on the needs and circumstances of a targeted customer profile.

We note that a social tariff would be separate from the VDO, however the VDO cost stack could serve as a reference point, with certain costs removed. For example, a social tariff could be structured with environmental costs including VEEC prices, and retail operating costs including customer acquisition and retention costs and bad debt, removed from the cost stack.

RECOMMENDATION 7. For the ESC in partnership with the Victorian Government to investigate the development of a social tariff for low-income Victorians, using the VDO cost-stack as a reference point.

SUMMARY OF RECOMMENDATIONS

RECOMMENDATION 1. If separating domestic and small business estimates of retail operating costs, the ESC should safeguard domestic customers from price increases by adopting a cap on retail operating costs in the VDO

RECOMMENDATION 2. The ESC set a low maximum limit on the estimate of retail operating costs in the VDO for domestic customers

RECOMMENDATION 3. For CARC to be removed from estimates of retail operating costs for domestic customers

RECOMMENDATION 4. For the ESC to select a lowest feasible retail operating margin for the VDO 2025-26

RECOMMENDATION 5. For the ESC to consider the systemic risks consumers face when determining retail margin.

RECOMMENDATION 6. For the ESC to consider the impacts of higher VEEC prices in the VDO for low-income consumers, and consumers experiencing vulnerability, when determing environmental costs

RECOMMENDATION 7. For the ESC in partnership with the Victorian Government to investigate the development of a social tariff for low-income Victorians, using the VDO cost-stack as a reference point.

Please contact Senior Policy Officer [redacted] at **Consumer Action Law Centre** on [redacted] or at [redacted] if you have any questions about this submission.

Yours Sincerely,

[redacted]

Stephanie Tonkin | Chief Executive Officer
CONSUMER ACTION LAW CENTRE