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Dear Dean and Jordan,

Victorian Default Offer to apply from 1 January 2020 Draft Decision

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Essential Service Commission (**ESC**) Victorian Default Offer to apply from 1 January 2020 Draft Decision (**Draft Decision**). The Victorian Default Offer (**VDO**) is an important protection that should ensure all Victorian households access a fair price for their essential electricity services. The ESC must focus on achieving the objective of the VDO, particularly that the price is reasonable in reflecting only the efficient costs of operating an electricity retail service.

While we largely support the Draft Decision, the ESC should adjust the proposed methodology for regulating the VDO compliant maximum bill to ensure fair and consistent outcomes for all disengaged households. In particular, the ESC should also reduce benchmark charges to households for retail operation costs, consumer acquisition and retention costs and retail margins. Decision makers must also put complementary policies in place to ensure that all who need the protection of the VDO actually default to it, that there is no barrier to accessing the VDO from any licensed retailer and that a VDO for gas is introduced. These adjustments to the Draft Decision and other complementary policy work will secure fair outcomes for all Victorian households as a result of the VDO.

A summary of recommendations is available at **Appendix A**.

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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Responses to the Draft Decision

Consistent VDO protections

The Draft Decision proposes requiring that non-flat VDO tariffs do not exceed the flat tariff costs at a representative consumption rate. This is generally likely to deliver lower prices for households on non-flat electricity standing offers, but it is not a consistent protection for households. The VDO's objective is to:

> *"provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market."*

To consistently access a simple, trusted and efficient cost for their electricity as determined by the ESC through the Draft Decision, disengaged households would have to 'land' on the exact representative consumption. This is near impossible and requires deliberate and skilled engagement. As soon as households consume a different amount of kWh per annum or vary their usage from the prescribed calculation for on and off-peak ratios, they are likely to get varying levels of price protection between different retailers. This is because retailers can vary the underlying structure of tariffs as long as they produce a tariff no higher than the flat VDO at representative consumption. Such requirements are therefore not simple, trustworthy or consistently reasonably priced and are an ineffective safeguard given the inconsistent pricing outcomes that households with the same consumption could experience.

The VDO protection is for households who are unwilling or unable to engage with energy retail markets. These same households will most likely be unaware of these complexities in the proposed protections from 2020. We urge the ESC to pursue a different mechanism to ensure that the work done to understand efficient pricing for the flat tariff VDO protection is applied consistently for disengaged households, who may or may not be aware that they are on a non-flat tariff. This may be a cap at individual consumption levels to the equivalent paid on a flat tariff VDO, as discussed in the issues paper, or another form of consistent protection. The outcome should be that households using flat or non-flat tariffs are protected through an equivalently priced VDO.

RECOMMENDATION 1. The ESC should not adopt its proposed Draft Decision in relation to the VDO compliant maximum bill. Instead the ESC should require retailers to provide consistent price protection outcomes for households accessing a non-flat tariff VDO.

Reduce Customer Acquisition and Retention Cost allowance

As Consumer Action has consistently outlined, Customer Acquisition and Retention Costs (**CARC**) are not efficient or likely to be incurred by disengaged households who are not 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. We urge the ESC to lower the benchmark in the draft decision and signal that it will continually reduce CARC allowance benchmarks to align with community expectations.

The Draft Decision proposes maintaining a CARC allowance of $38 per household on average based on CARC expenditure in the NEM five years ago before a significant increase in CARC costs. It is in household's interests to continually reduce this benchmark to better reflect modest spending. If the ESC asked people directly, we would expect that most would prefer not to pay for CARC costs like television advertising, billboards, door to door sales commissions and so on. The ESC is able to place this pressure on retailers to increase the efficiency of spending in order to achieve CARC's objective with modest costs.

As we understand it, the objective of CARC is to provide a signal to households as to the electricity options available to them that may best suit their needs. This is also understood to encourage competition by putting pressure on retailers to provide features in electricity plans that consumers wish to access. However, the Thwaites review and ACCC Retail Electricity Pricing Inquiry found that instead the costs have just forced an 'arms race' where retailers try to outspend on each other and charge households. They also found that the benefits of such competition were not delivering good outcomes for all.[1]

In most cases consumers simply want a low price for energy. Currently in Victoria the most efficient and reliable means of identifying what is available to meet this and other commonly desired product features is the use the Victoria Energy Compare (**VEC**) website. The Victorian Government provides significant funding for this service and its promotion. We are concerned that costs for measures towards the CARC objective are borne twice by households, through their energy bills and through taxation. CARC incurred through retailers' bills is more likely to reduce the efficiency of households finding the most appropriate retail services through VEC. This is because direct advertising generally discourages comparisons from being made on the VEC or makes these comparisons more confusing for households.

Energy retailers are also now required to tell consumers if they are on that retailer's best energy plan for their circumstances, further eliminating the need for consumers to rely on advertising to discover energy price deals. The cost for this measure will already be incorporated in the regulatory allowance for the VDO.[2]

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 set a progressively lowering benchmark for CARC costs at each VDO reset. This will give retailers sufficient notice to lower spending in between each price reset while increasingly delivering fairer outcomes for households.

In setting the VDO price for 2020, the ESC should also lower the benchmark costs for CARC based on the upcoming prohibition of undesirable practices that contribute to CARC costs and to exclude excessive costs from third party comparators. The Victorian Government has committed through its Energy Fairness Plan to prohibit energy retailers from conducting unsolicited sales or win back offers.[3] Incurring costs for these practices does not align with community expectations about modest costs and will not occur in the future. The estimated proportion of the CARC benchmark that would enable such practices should be removed from the benchmark.

The ACCC REPI also pointed to the excessive cost of acquisition through third party comparison services as a major issue:

> *"Retail costs, particularly those associated with acquiring customers (such as marketing and commissions paid to third party comparators) are significant and have been growing since markets were opened to competition."*[4]

Retailer data gathered for that report indicated that acquisition from a third-party cost around $200.[5] The REPI also discussed concerns in relation to how these services do not act in the interests of households. Recently some retailers have reported that they have stopped working with some third-comparator services that do not present offers in a format that is easily understood and comparable.[6] This should be expected of all companies in an

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[1] Faulkner, Mulder and Thwaites, 2017. *Independent review of the electricity & gas retail markets in Victoria.*
ACCC, 2018. *Restoring electricity affordability and Australia's competitive advantage; retail electricity pricing inquiry – final report.*
[2] ESC, 2019. *Getting the best energy plan; New rules introduced on 1 July 2019 make it easier for you to know if you're on the best available energy plan.* Retrieved 17 October 2019 from: https://www.esc.vic.gov.au/electricity-and-gas/information-consumers/getting-best-energy-plan
[3] Victorian Labor, 2018. *Cracking Down on Dodgy Energy Retailers – Labor's Energy Fairness Plan.* Retrieved 15 October 2019 from: https://static1.squarespace.com/static/5b46af5a55b02cea2a648e93/t/5bf3264f21c67ce36dc6f142/1542661716026/CRACKING+DOWN+ON+DODGY+ENERGY+RETAILERS+%E2%80%93+LABOR%E2%80%99S+ENERGY+FAIRNESS+PLAN+%281%29.pdf
[4] ACCC, 2018. *Restoring electricity affordability and Australia's competitive advantage; retail electricity pricing inquiry – final report* p.xi
[5] Ibid, p.231
[6] Energy Australia, 2019. *EnergyAustralia backing modern energy system despite tough first half.* Retrieved 15 October 2019 from: https://www.energyaustralia.com.au/about-us/media/news/energyaustralia-backing-modern-energy-system-despite-tough-first-half

environment where CARC is modest and delivering its objectives. Therefore, the ESC should estimate the proportion of costs in the benchmark that enable retailers to utilise these services and remove that cost from the benchmark.

RECOMMENDATION 2. Provide a signal to retailers that the benchmark for modest CARC will lower over time in line with community expectations.

RECOMMENDATION 3. Reduce the benchmark allowance for CARC by removing the estimated proportion of that benchmark that would enable spending on unsolicited selling, win-backs and engaging third-party comparison services.

Ensure retail operation cost allowance benchmarks reflect efficiency

We repeat our calls to lower the benchmark for retail operation costs. The proposed benchmark for retail operation costs increased by $29, to $134, following the provision of information from retail businesses after the ESC's draft advice to government for the VDO prices to apply from 1 July.[7] We are not confident that this can be adequately scrutinised to ensure costs are not inefficient, therefore the ESC should go back to its draft advice to government for the VDO prices to apply from 1 July 2019. That draft advice accepted an average of $96.66 per customer for operating costs from the REPI and added further adjustments.[8]

This $96.66 figure was from the ACCC REPI which appears to be the most comprehensive and reliable assessment of retailer costs. Relying on this information is preferable to relying on the ICRC's 2017 retail operating costs decision which itself relied on benchmarks from other regulators. This circular approach risks Victorian households paying for inefficient costs when the ACCC has identified lower costs from analysing actual retailer data.

We have still not seen what disaggregated data was requested of retailers and will not have the ability to review it, demonstrating the information asymmetry at play for consumer groups. Similarly, the ESC only receives the information that retailers provide. Retailers have an incentive to present costs in a way that convinces the ESC to increase the allowance. The ESC should favour lower costs wherever possible to counter the risk of over representation of costs or that these costs include inefficiencies.

Retailers have claimed that the benchmark for operating costs should be increased as they claim that they face increased costs for bad debt. However, such claims of costs in relation to bad debt should be understood to be inefficient management by the companies making such claims. This can be evidenced in our services seeing ongoing issues with retailers not providing effective early intervention to ease payment difficulty.[9] These issues create unnecessary costs for customers, companies, ombudsman, government support services and the community sector to resolve. If companies comply with the Payment Difficulty Framework and assist early intervention assistance in a timely way, then households are less likely to end up in situations where large energy debts cannot be paid. When complying with the Payment Difficulty Framework, retailers are also likely to be incurring less costs for external dispute resolution complaints that arise due to ineffective assistance. Recent reports from EWOV confirm that the ombudsman is receiving less complaints in this area.[10]

Also, the $134 figure proposed in the Draft Decision includes a $10 allowance for the cost of transitioning to new regulation in Victoria. New regulations like the VDO as well as bills and marketing changes were implemented on

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[7] ESC, 2019. *Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government*, p.6
[8] ESC, 2019. *Victorian Default Offer to apply from 1 July 2019; Draft advice*, p.49
[9] Consumer Action, 2019. *Energy Assistance Report; Tracking how Victoria's changing energy policies are impacting households in the state.*
[10] EWOV, 2019. *Annual Report 2019*, retrieved 15 October 2019 from: https://www.ewov.com.au/files/ewov_2019_annual_report.pdf

1 July 2019 and businesses should have already undertaken implementation work. Therefore, this proportion of costs should now be removed from the benchmark as opposed to creating an ongoing inefficient 'buffer.'

We also request that the ESC does work so that the public can trust that gas retail services costs are not inappropriately included in considerations for the retail operating costs benchmark in the VDO for electricity. How retailers divide up the cost for retail gas and electricity services that are provided by the same staff at the same time must be thoroughly scrutinised in data provided to the ESC to ensure this has not inflated suggestions for the benchmark allowance. Retailers that offer both fuels have an incentive to overestimate the proportion of costs incurred in the provision of electricity services to increase what is seen as reasonable in benchmarking for retail costs. The ESC may not have oversight of these costs being double counted (and charged to households) for both the provision of gas and electricity. The ESC must also ensure that it can identify where retailers increase margins in gas retail services due to regulation of electricity prices at efficient rates. It should recommend the regulation of gas prices to protect disengaged households from this issue if it arises.

RECOMMENDATION 4. Set the benchmark for retail operating costs at the average amounts reported by the ACCC Retail Electricity Pricing Inquiry for 2017-18.

RECOMMENDATION 5. Do not increase the benchmark on the basis of costs for bad debt as these reflect inefficient practices.

RECOMMENDATION 6. Do not include an amount for transition in the benchmark for retail operating costs.

RECOMMENDATION 7. Thoroughly scrutinise whether shared costs for supplying gas and electricity energy services are being accurately reflected in the work done to determine appropriate benchmarks for retail operating costs.

Limit retailer operating margins

We reiterate our views from the issues paper stage of this process. The ESC should assess an acceptable range for retailer margins and set the allocation for this at the low end of the range to counter issues with information asymmetry between industry, regulators and consumers. Analysis from Frontier Economics for the VDO pricing to be set from 1 July 2019 produced a range with a low of 4.4 per cent. This amount should be adopted by the ESC instead of the circular process of relying on other regulator's historic decision making, which often may rely on other regulator's decisions. Alternatively, the ESC should again commission updated independent advice regarding efficient retailer operating margins and set the allowed margin at the low end of that range.

RECOMMENDATION 8. The ESC set the retail operating margin at 4.4 per cent or commission independent modelling as to an appropriate benchmark for efficient retail operating margin and set the allowance at the lowest point of any range given.

Other issues

True ups

We reiterate our concerns from our previous submission to the issues paper about circumstances that may arise where modelling for costs doesn't reflect the actual costs to businesses for providing the VDO. The ESC must create a system to ensure unnecessary payments are returned to Victorian households as opposed to becoming additional margins for businesses where such circumstances arise.

RECOMMENDATION 9. Refunds are provided to households in scenarios where modelling means households are burdened by unnecessary costs.

Access to the VDO

Complementary policies are needed to ensure that the VDO achieves its objective. Alongside this price setting process, other policies must be developed to ensure that households who are unable or unwilling to engage, actually default to the VDO when they are paying a higher price. Those on market offers without terms that default to the VDO at any stage are not effectively protected otherwise. The ESC's Fair and Clear Contracts reform work should address this issue.

Calls to the National Debt Helpline Consumer Action since 1 July 2019 indicate that the VDO is not yet an effective safeguard for those unable to engage with the energy market due to credit checking, where they move into a property and electricity is disconnected. A recent call involved a retailer withdrawing a market offer due to credit checking but failing to effectively explain to a vulnerable Victorian that they were entitled to electricity and how to access the VDO. This is one of several barriers households may face when trying to find out who the financial responsible market participant (**FRMP**) is at a property and getting that retailer to recognise they are the FRMP that must supply through the VDO.

Electricity is an essential service that is needed to ensure health, wellbeing and social participation. Those credit checked out of the competitive market may be in particularly vulnerable situations that have caused financial problems to appear on their credit reporting. It is people in these situations who are most in need of an energy safety net. Although we have seen very limited instances of this issue arising, it should not arise at all Households, especially vulnerable ones, should not have to overcome barriers in order to ensure they have access to the VDO and a fair energy price. Instead, to provide a simple and trusted safeguard, complementary policy must require all retailers to provide the VDO to anyone who requests it.

The issues with the electricity market that lead to the implementation of the VDO for electricity still occur in the gas market. These issues include large price dispersion, confusing discounts, complex decision making for households and unnecessary costs for competition. Gas is also an essential service like electricity and needs effective protections. 1.9 million customers in Victoria use gas.[11] Gas tariffs offered to households vary in structure between retailers more often than electricity offers so are more complex to compare and engagement is more challenging. Significant harm can be caused where all Victorian households do not have access to a fair price for gas. For these reasons, the Victorian Government must also task the ESC with setting a Victorian Default Offer for gas through the use of a bottom up methodology.

RECOMMENDATION 10. The ESC implement complementary policies to ensure that households default to the VDO when they are unwilling or unable to engage.

RECOMMENDATION 11. The ESC recommend that the Victorian Government improve disengaged households' access to VDO protections and oblige all retailers to offer the VDO to all Victorian households who request it.

RECOMMENDATION 12. The Victorian Government tasks the ESC with implementing a Victorian Default Offer for the supply of gas.

[11] AER, 2019. *Affordability in retail energy markets; September 2019.* Retrieved 15 October 2019 from: https://www.aer.gov.au/system/files/Affordability%20in%20retail%20energy%20markets%20-%20September%202019_0.pdf

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

Yours Sincerely,
CONSUMER ACTION LAW CENTRE

Gerard Brody | Chief Executive Officer

APPENDIX A - SUMMARY OF RECOMENDATIONS

RECOMMENDATION 1. The ESC should not adopt its proposed Draft Decision in relation to the VDO compliant maximum bill but instead require retailers to provide consistent price protection outcomes for households accessing a non-flat tariff VDO.

RECOMMENDATION 2. Provide a signal to retailers that the benchmark for modest CARC will lower over time in line with community expectations.

RECOMMENDATION 3. Reduce the benchmarked allowance for CARC by removing the estimated proportion of that benchmark that would enable spending on unsolicited selling, win-backs and engaging third-party comparison services.

RECOMMENDATION 4. Set the benchmark for retail operating costs at the average amounts reported by the ACCC Retail Electricity Pricing Inquiry for 2017-18.

RECOMMENDATION 5. Do not increase the benchmark on the basis of costs for bad debt as these reflect inefficient practices.

RECOMMENDATION 6. Do not include an amount for transition in the benchmark for retail operating costs.

RECOMMENDATION 7. Thoroughly scrutinise whether shared costs for supplying gas and electricity energy services are being accurately reflected in the work done to determine appropriate benchmarks for retail operating costs.

RECOMMENDATION 8. The ESC set the retail operating margin at 4.4 per cent or commission independent modelling as to an appropriate benchmark for efficient retail operating margin and set the allowance at the lowest point of any range given.

RECOMMENDATION 9. Refunds are provided to households in scenarios where modelling means households are burdened by unnecessary costs.

RECOMMENDATION 10. The ESC implement complementary policy to ensure that households default to the VDO when they are unwilling or unable to engage.

RECOMMENDATION 11. The ESC recommend that the Victorian Government improve disengaged households' access to VDO protections and oblige all retailers to offer the VDO to all Victorian households who request it.

RECOMMENDATION 12. The Victorian Government tasks the ESC with implementing a Victorian Default Offer for the supply of gas.