

# Getting the VDO right

Joint submission on the Victorian Default Offer Review 2024-2025 draft decision



APRIL 2024

**This submission represents the shared view of leading Victorian community sector organisations and energy consumer advocates.**

This is a joint submission made by the Victorian Council of Social Service, Consumer Action Law Centre, Energy Consumers Australia, Federation of Community Legal Centres Victoria, and Financial Counselling Victoria. This group brings a deep knowledge of people's experiences navigating the Victorian electricity market and the impacts of energy hardship and poverty. Collectively, we work towards a Victoria free from all forms of hardship, where everybody can experience genuine wellbeing.

### **The proposed reduction is welcome but will not create energy affordability**

We welcome the decision by the Essential Services Commission (ESC) to propose reducing the average bill of the Victorian Default Offer (VDO) by an average of 6.4 per cent. Any reduction in electricity prices is welcome.

However, in the context of a 25 per cent increase last year, a prior increase of 5 per cent in 2022-2023 – set against a backdrop of increased cost of living pressures across housing, transport, food, and health – this decision will deliver little relief. Too many Victorians will remain trapped in poverty; unable to pay their energy bills or forced to make heartbreaking decisions, such as whether to heat or eat.

In response to the draft price, we maintain the view in our previous joint submission that the formula needs updating, with less emphasis on the retailers' profit margins and corporate health, and more of a focus on the wellbeing of struggling Victorians.

### **We question the modest reduction in the wholesale portion of the VDO**

In our initial submission, we advised that the VDO is an important mechanism for ensuring savings from settling wholesale prices are passed on to customers. While we acknowledge that the wholesale portion of the VDO pricing has come down, by 22 per cent on average, we question whether this reduction is sufficient to accurately capture current wholesale market prices.

Since the energy crisis in 2022 we have seen futures electricity prices in Victoria reduce significantly, continuing to follow a downward trend.<sup>1</sup> At the same time, the Australian Energy Market Operator continues to record declines in wholesale spot prices in the National Energy Market (NEM), reporting a 48 per cent decline in Q4 2023 compared to a year earlier.<sup>2</sup>

We recommend that, accordingly, wholesale costs be further reduced to reflect market cost reductions.

We understand that the ESC's setting of wholesale prices involves a calculation based on modelling the hedging behaviours of retailers. Ostensibly, this retailer hedging protects both retailers and customers from the potential volatility of the wholesale market. In practice however, large retailers can hedge their contracting to avoid costs, while passing higher rates on to customers, and make significant profits over time. Accordingly, we would like to see continual monitoring of the broad range of risk management strategies used by retailers when purchasing wholesale futures, to ensure that the VDO wholesale portion is accurately reflecting the real cost of purchasing electricity.

In the draft decision, the ESC states: "... very strong evidence would be required for us to change our established approach to calculating prices."<sup>3</sup>

We observe that the type of evidence the ESC requires before considering any adjustment to the methodology is beyond the capacity of most organisations in our sector to produce. As it stands, many community service organisations and consumer advocates struggle to participate in consultations (such as this one) because of financial and other resource constraints. We have no resources to model complex markets such as wholesale spot pricing and futures markets. We note that this is not beyond the capacity of electricity retailers to produce, and we reflect that this disparity represents a power imbalance in the price-setting process.

We believe the ESC and consumer advocates alike would benefit from well-resourced, open, and transparent independent consumer-focused economic modelling, to address information asymmetry in this context.

### **Customers need more help to navigate the energy market and find affordable electricity market offers**

We would like to reiterate that while the VDO is a crucial safeguard, it is rarely the offer that would provide people with the best value, and every effort must be made to ensure people are not languishing on plans with unnecessarily high prices.

---

1 Leading Edge Energy, *March 2024 Electricity Market Review*.

2 Australian Energy Market Operator (2024), *Quarterly Energy Dynamics Q4 2023*, p11

3 Essential Services Commission, *Victorian Default Offer 2024–25: Draft Decision Paper*, p6.

In 2022–23, 13.6 per cent of Victorian consumers were on the VDO, up from 11.9 percent in 2021–22.<sup>4</sup> Approximately 20 per cent of small business consumers were on the VDO in 2022–23, up from around 17 per cent in 2021–22.<sup>5</sup> Many of these customers would benefit from assistance to switch to the best and most affordable market offer for their situation.

Especially concerning are recent Australian Competition and Consumer Commission (ACCC) findings that retailers tend to regain their costs over time by putting up costs after offering competitive initial prices, with people ending up on plans at or above default offers.<sup>6</sup> Effectively a “loyalty tax.”

The ACCC found that in Victoria in 2023, 41 per cent of residential customers on flat rate unconditional offers (no conditional discounts) were paying equal to or more than the VDO, with nine per cent paying over 25 per cent more than the VDO.<sup>7</sup> Further, the ACCC found that 33 per cent of residential customers on flat rate conditional offers (assuming 100 per cent achievement of discounts) were still paying equal to or more than the VDO.<sup>8</sup> And nationally, 79 per cent of residential customers could save money by switching to a competitively priced acquisition offer.<sup>9</sup>

In all of these contexts the ESC should ensure that retailers are fulfilling their regulatory obligations to offer customers their best market offer, support efforts such as the Energy Assistance Program that assists customers in hardship navigate the market, and work with other Victorian Government agencies and departments to reduce structural barriers that customers face in switching retailers. The ESC should also continue to play a strong regulatory role in protecting energy consumers rights through mechanisms including the Energy Retail Code of Practice.

### **Pricing must be considered in the broader cost of living context**

Big retailers have profited greatly since wholesale prices have settled<sup>10</sup>, while bills remain high. We urge the ESC to re-centre the impacts of costs on people, rather than companies, in regulatory decisions.

---

4 Essential Services Commission (2023), [Victorian Energy Market Report: September 2023](#), pp39-40.

5 Ibid.

6 Australian Competition and Consumer Commission (2023), [Inquiry into the National Electricity Market](#), p9.

7 See: Supplementary Table C9.6 in [Appendix C - Supplementary Excel spreadsheet with cost stack data and charts](#), from: Australian Competition and Consumer Commission (2023), [Inquiry into the National Electricity Market](#).

8 See: Supplementary Table C10.6 in [Appendix C - Supplementary Excel spreadsheet with cost stack data and charts](#), from: Australian Competition and Consumer Commission (2023), [Inquiry into the National Electricity Market](#).

9 Australian Competition and Consumer Commission (2023), [Inquiry into the National Electricity Market](#), p5.

10 Australian Financial Review (February 2024), [Power bill increases swell AGL's profits](#); Australian Financial Review (February 2024), ['Better if we are stronger': Origin CEO defends profit surge](#).

Community service organisations are at the front line of the current cost of living crisis. These organisations are experiencing unprecedented demand from Victorian households that are struggling to absorb mounting costs, not least among them the costs of electricity.

The Victorian Energy Market Report for 2022-2023 noted that retailers provided tailored assistance to an average of 65,268 electricity customers in any given month, an increase of five per cent compared to the previous financial year.<sup>11</sup> Once gas customers in hardship are included, we see that the highest average number of customers were accessing tailored assistance in November 2023 since the commencement of the Payment Difficulty Framework.<sup>12</sup> Customers are also spending longer on tailored support, fewer are able to afford their ongoing costs while receiving assistance, and a lower percentage are leaving tailored assistance with no debt.<sup>13</sup> This indicates a deeply concerning trend of worsening affordability and increased energy hardship.

With reference to the objectives of the Commission in promoting the long-term interests of Victorian consumers, this suggests the ongoing need for the Commission to consider the role of energy costs as part of the longer-term hardship faced by consumers.

The cost of electricity increased by 14 per cent as measured in the Consumer Price Index from March 2019 to September 2023.<sup>14</sup> Electricity bills represent a much higher share of the ongoing living expenses of low-income households, and their limited financial resources leave them with few options to reduce their energy demand safely and sustainably. As energy bills and expenses such as rent, council rates, and telecommunications bills tend to be non-negotiable, many low-income households resort to dangerously low levels of energy use or the rationing of other essentials such as food.

A shocking and unacceptable consequence of higher energy bills and associated heating and cooling costs is ill-health and excess deaths<sup>15</sup> – all of which can be prevented by making the right policy and regulatory choices.

Pricing determinations for electricity do not occur in a vacuum. The ESC has a statutory obligation to have regard for the benefits and costs of its regulatory decisions on low income and vulnerable consumers.

---

11 Essential Services Commission (2023), [Victorian Energy Market Report:2022-2023](#), p7

12 Essential Services Commission (2024), [Victorian Energy Market Report: March 2024](#), p20.

13 Essential Services Commission (2023), [Victorian Energy Market Report:2022-2023](#), p8-9; Essential Services Commission (2024), [Victorian Energy Market Report: March 2024](#), p20.

14 Australian Bureau of Statistics (2023), [Consumer Price Index, Australia, September Quarter 2023](#).

15 Northwestern Institute for Policy Research (2020), [When Heating Is More Affordable, Fewer People Die: Policy Brief March 2020](#); see also: Victorian Council of Social Services (2021), [Feeling the Heat](#).

To that end, we again recommend that wherever there is a range in price estimates in a portion of the VDO price stack, the ESC should select the lowest price estimate, or have stated reasons why the lowest price was not selected.

Furthermore, the ESC should investigate how *all* pricing and regulatory determinations made for essential services in Victoria impact the cost of living and consider mechanisms that work to embed this holistic view of financial burdens for essentials into *all* determinations.

Beyond the 2024-2025 review, the ESC should investigate measurements of consumer impacts including income and household expenses with a view to incorporating these indicators within the methodology of the VDO 2025-26.

**The VDO should be just one part of a complimentary set of policies designed to create affordability**

The objective of the VDO is to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market.<sup>16</sup> In many ways, especially in eliminating unreasonably high-priced standing offers from the market, the VDO has succeeded in its objectives. We strongly believe that the VDO should continue to play a crucial role in the Victorian electricity market.

In the present context of high prices and increasing market complexity, it is crucial that the VDO is always renewed, examined, and strengthened, to ensure that it can indeed be defined as a “trusted and reasonably priced electricity option.”

However, a price that is calculated based on the costs of an unfair and unaffordable market cannot create affordability alone. This lack of affordability is compounded by the well-established complexity of engaging with the market at all, especially for low-income households.

As such, regulators and policymakers should investigate complimentary measures, above and beyond the VDO and the concessions system, to deliver an essential service like electricity to low-income households at a truly affordable rate.

---

<sup>16</sup> Essential Services Commission, *Victorian Default Offer 2024–25: Draft Decision Paper*, p3.

### Recommendations:

1. The VDO should be maintained as a crucial safeguard for consumers who cannot engage with the market, and as price cap for those in embedded networks.
2. Wholesale costs should be further reduced to reflect wider market cost reductions.
3. The ESC should ensure that retailers are fulfilling their regulatory obligations to offer customers the best market offer, support efforts such as the Energy Assistance Program that assists customers in hardship navigate the market, and work with other Victorian Government agencies and departments to reduce structural barriers that customers face in switching retailers.
4. Whenever there is a range in price estimates for a component of the VDO price stack, the ESC should select the lowest price estimate or have stated reasons for why the lowest price was not selected.
5. The ESC should investigate measurements of consumer impacts, including income and household expenses, with a view to incorporating these indicators within the methodology of the VDO 2025-26.
6. Across all essential services, the ESC should work to embed a holistic understanding of the cost of living into all pricing determinations.
7. Regulators and policymakers should examine mechanisms that complement the VDO to create real affordability for low-income households trying to afford an essential service.