Level 6, 179 Queen Street
Melbourne, VIC 3000

info@consumeraction.org.au
consumeraction.org.au
T 03 9670 5088
F 03 9629 6898

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Submitted via Engage Victoria

Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC 3000

Dear Commissioners,

Victorian Default Offer 2023-24: Draft Decision

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Essential Services Commission's (**ESC**) Draft Decision for the Victorian Default Offer (**VDO**) for 2023-24.

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

To date, we believe that the VDO has been successful in achieving the policy objective of providing consumers unable or unwilling to engage in the market with a simple, trusted and reasonably priced electricity option. However, given the cost-of-living pressures Victorians are currently facing, it is critically important that the VDO continues to deliver against this objective in the coming regulatory period.

While we have been and remain supportive of the VDO, we recommend a meaningful reduction to the proposed 31% increase in the 2023-24 VDO price. We acknowledge that high wholesale electricity prices across the past 12 months necessitate an increase from the previous VDO, however, we suggest that the ESC reconsiders several aspects of its draft decision to ensure that any price rise is minimised, particularly in the context of provision of essential services. These aspects include review of the wholesale cost methodology, and smaller changes to the calculations of retail operating costs and retail margin.

More detailed comments on these points are provided below.

Cost of living concerns

Thousands of Victorians are struggling to cover their basic living expenses amid the current cost-of-living crisis. The number of people doing it tough is reflected in the demand for our frontline services – calls to our financial counsellors through January and February 2023 are around 30% higher than the same time in 2022. These calls are increasing in complexity, as is the extent of financial hardship. The ESC's latest Victorian Energy Market Report notes that not only are increasing numbers of people receiving payment assistance from their retailers, but that average debt levels among these customers is also rising.[1] A 31% increase to the VDO will only further exacerbate this crisis. The ESC itself has acknowledged this fact, noting in the Draft Decision that the proposed price rise will be tough on Victorian energy consumers.[2]

We agree with the ESC's statement in the Draft Decision that ensuring people can access government support, and that retailers are complying with their obligations to provide payment assistance to their customers, has a critical role to play to helping people weather these price rises. However, we also consider that minimising price rises is just as important. Even a small reduction to the price in the final decision will provide meaningful relief to Victorians currently struggling to make ends meet.

In making their final decision we urge the ESC to consider the proposed price rise with regard to the impact on consumers. Under the Essential Services Act 2001, the ESC is required to have regard to the costs and benefits of regulation on consumers, including people in vulnerable circumstances or on low incomes.[3] Given the degree of financial strain people are currently experiencing, we believe that the ESC must give precedence to the impact on consumers when making their final decision.

Wholesale costs methodology

As expected, wholesale electricity prices are the major driver of cost increases in the Draft Decision. We accept that high wholesale electricity prices across the past 12 months necessitate an increase in the 2023-24 VDO. However, we question whether the extremely high prices of late-2022 should be included in the calculation used to arrive at the proposed 2023-24 price. We suggest that in making their final decision, the ESC considers how to deal with the prices of the last 12 months in the final decision, as well as the trend towards lower prices in 2023-24. We consider that the unprecedented prices of the past 12 months are such an outlier that they justify a deviation from the standard methodology in this decision.

Furthermore, as we have previously noted, Frontier Economics have themselves identified that the methodology used to estimate wholesale electricity costs are generous, and that efficient retailers should be able to achieve wholesale costs below the estimate. Frontier Economics have again included this point in their report for the ESC on 2023-24 costs.[4] In addition, we note that the VDO methodology already protects retailers from the impacts of impacts of wholesale price volatility, through the inclusion of a volatility allowance. Given this allowance is already included in the methodology, we question if this does not already address at least some of the price volatility seen in 2022.

Given the impact of wholesale prices as the primary driver of cost increases in the 2023-24 VDO, it is essential that the ESC further interrogates the methodology to ensure that the estimate used accurately reflects costs incurred by an efficient retailer before making its Final Decision.

Retail operating costs

Overall, we strongly support the ESC's decision to set the retail operating cost benchmark based on retailer's actual operating costs. This is something we have called for several times since the introduction of the VDO, so we are pleased to see the ESC pursue this approach.

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[1] Essential Services Commission (2023), *Victorian Energy Market Report: March 2023*, p.13
[2] Essential Services Commission (2023), *Victorian Default Offer 2023-24: Draft Decision Paper*, p.5
[3] Essential Services Commission Act 2001 (Vic), p.16
[4] Frontier Economics (2023), Wholesale electricity costs for 2023/24: A draft report fort the Essential Services Commission, p.45

As we said in our submission in response to the Consultation Paper for the 2023-24 VDO, comparing retailers' actual costs to the benchmark currently in use was necessary to confirm that the benchmark remained reflective of current costs. We also noted in our submission recent statements from both the ESC and the Australian Competition and Consumer Commission (**ACCC**) that suggested retail operating costs were declining. We are pleased see this borne out by the ESC's data gathering.

However, ahead of the Final Decision, we question if using an average (even a customer weighted average) best represents the costs of an 'efficient' retailer? We suggest an 'efficient' retailer would be below the average. Given this, we recommend that in the final decision, the ESC selects a cost towards the lower end of any range obtained, as this would better represent the costs of an 'efficient' retailer.

We also suggest that the ESC considers what happens if retail operating costs increase. There must be some review or verification process in place to ensure any increased costs are 'efficient'. If the VDO is to remain a reasonable price (as set out in the pricing order), it must reflect the efficient cost of retail energy services. The methodology should ensure that past inefficiencies are not accounted for in the price, as well as guarding from future inefficiencies creeping in. This could involve returning to a benchmark, or the application of a productivity factor which would exert downward pressure on costs.

Despite these minor points, we strongly support the decision to use retailer data and recommend that it is retained in the Final Decision.

Customer acquisition and retention costs

In line with the above points on retail operating costs, we also note the decision on customer acquisition costs. As for operating costs, in our submission in response to the Consultation Paper we suggested that the ESC collects retailer data on customer acquisition and retention costs (**CARC**) to understand if the benchmark remained valid.

We note that the ESC's data gathering found that retailer spending on CARC was above the benchmark currently in use. Given this, we support the ESC's decision to retain the current benchmark as more representative of 'modest' expenditure on CARC (as required by pricing order). This data gathering also underlines the importance when collecting retailer data, of having a benchmark in place (or another process) to verify that the costs found represent the behaviour of an 'efficient' retailer. Where retailer expenditure cannot be justified as 'efficient', it is essential to have an alternative figure that can be included in the cost stack in place of actual retailer costs.

Retail operating margin

Finally, we note the impact of retail margins on the proposed 2023-24 VDO. Having a percentage margin which is calculated on the top of the entire cost stack means that as other costs go up the dollar value of the margin also increases. Given the current cost of living pressures impacting the community, we believe that the ESC must reduce the retail margin in their Final Decision.

In our submission responding to the Consultation Paper, we repeated our long-held position that the ESC considers reducing the retail margin given that we believed the benchmark in use to be overly generous. As for retail operating costs, we also suggested that the ESC collects retailer data to understand if the current benchmark in use remained justifiable. We note that the ESC's data gathering found the average retail margin in Victoria to be 4.8%, below the benchmark of 5.7% currently in use. In making the Final Decision, we recommend that the ESC uses retailer data to set the margin, as it has for retail operating costs.

Beyond the benefit of consistency in how aspects of the cost stack related to retail costs are calculated, we also consider the margin should be reduced in line with the requirement that the ESC has regard to the costs and benefits of regulation on consumers. During a period of elevated supply costs, we would expect to see retailer margins decrease. Business should be expected to share the costs of market volatility, rather than simply increasing prices to protect profit margins. Given the extent of financial hardship currently in the community, and the fact we are talking about essential services, a reduction in the margin is important as a signal that the impact on people takes precedence over the impact on profit. The ESC should be looking at all avenues to reduce costs ahead of the Final Decision, and a reduction in the retail margin will make a meaningful difference for Victorians struggling with day-to-day living expenses.

Thank you again for the opportunity to comment on the Draft Decision. Should you wish to discuss any of the issues raised in our submission, please contact Luke Lovell, Senior Policy Officer at luke@consumeraction.org.au or on (03) 9670 5088 for more information or to arrange a meeting.

Yours sincerely,

CONSUMER ACTION LAW CENTRE

Stephanie Tonkin | Chief Executive Officer