



Victorian Energy Market Report 2016-17

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<https://www.esc.vic.gov.au/wp-content/uploads/2017/11/victorian-energy-market-report-2016-17-20171121.pdf>

For many years, the Essential Services Commission has been producing reports on the state of the Victorian energy market. Two years ago, we redesigned our approach and today we are releasing our second *Victorian Energy Market Report*. This is the most comprehensive report of its kind produced for Victorian customers.

This is an important report. It's an honest report. We don't gloss over the inconvenient truths about the energy market here in Victoria.

The retail energy market is working well for some customers but others are getting a pretty raw deal, costing them hundreds of dollars a year.

Our report consists of three parts:

First, an overview document which has been designed to make it as easily accessible to as many readers as possible. Not only is this an overview of the market, we also set out to explain how the market works and what customers can do to get the best out of the market.

Second, we have prepared easy-to-read profiles (or a report card) on the energy companies operating in Victoria. This allows Victorians to see how their energy company performs and to see how their provider compares to its competitors. I would encourage everyone to look at these profiles as they highlight which companies have performed well over the last year, and where companies need to lift their game.

Third, in the interests of full disclosure, we will be making all the data that sits behind these reports available on our website so that independent researchers, analysts or commentators can undertake their own assessments about the state of the Victorian energy market.

Unfortunately, due to staff illness over the last week, the second and third parts of the report will only be available later this week — however, the overview we’re releasing this morning provides some fascinating insights into how our energy market is working. It also highlights, what happens when the market isn’t working so well.

Just two caveats before we get started. The report focuses on overall outcomes. This means individual customers may have had experiences that don’t exactly match the overall outcomes we’re reporting today. And second, this report covers the period to the end of June this year (financial year 2016-17). Of course, things have continued to evolve since then. Indeed, just two days ago, there was an article in the print media foreshadowing large price increases from next January. Those increases are not included in this report.

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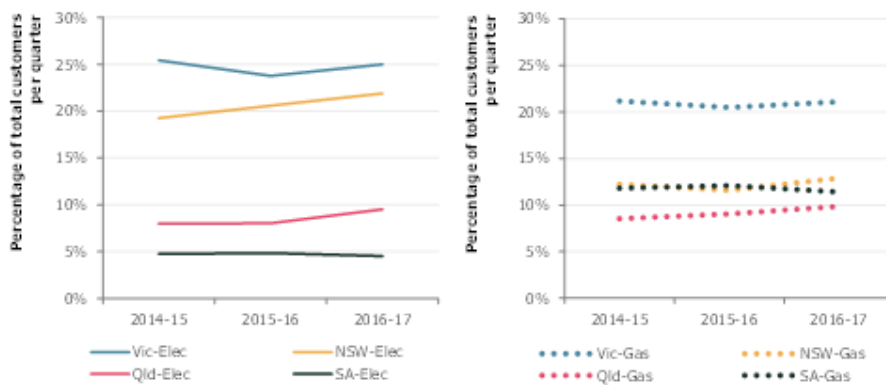
A few general observations to start-off.

- **Medium-sized and small retailers have shown solid growth in the last year.** While some of this growth came at the expense of the larger retailers, the rest reflects medium-sized and small retailers benefiting from population growth.
- **Switching rates in Victoria haven’t changed in the last year** with 25 per cent of electricity customers and 21 per cent of gas customers opening new accounts in 2016-17. Just a word of caution: These figures include new customers and customers moving house, so they don’t actually tell us how many customers actively set out to switch to a better deal. We broadly estimate that only half of these customers were “active switchers”.
- **There is a continuing trend away from fixed-term to ongoing contracts in the retail electricity and gas markets.** This is an interesting development. Traditionally, the end of a contract has acted as a prompt for customers to re-engage with the market in search of a better offer. The shift by retailers towards

ongoing contracts mutes the effectiveness of this prompt and potentially facilitates greater customer disinterest in engaging with the market — or what’s called, “customer inertia”.

Customer transfers

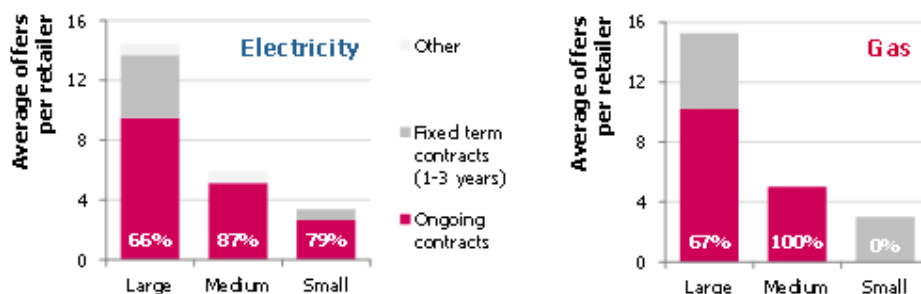
- 25 per cent of electricity customers and 21 percent of gas customers opened new accounts in 2016-17.



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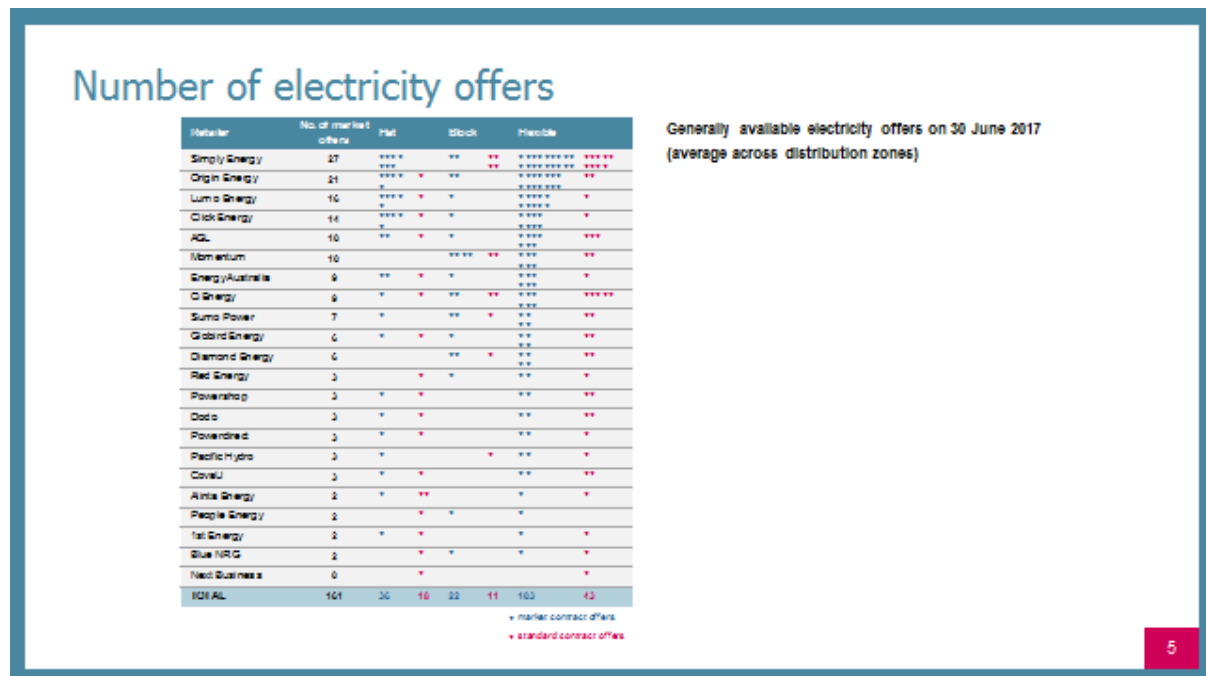
Structure of contracts

- There is a change underway in how retailers are structuring their contracts.
- Contracts now tend to be on-going rather than fixed term.



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- An electricity customer who looks online for a new electricity deal will typically find themselves facing a list of over 230 generally available offers. Each dot in this diagram represents a separate offer.



The prices, tariff structures, terms and conditions of these contracts can vary significantly. These variations include:

- the term of the contract or whether it's ongoing
- the structure of the tariffs
- the split between the fixed supply charge and usage charges
- whether discounts are available
- whether discounts are conditional on any actions by the customer (such as paying on time or arranging direct debit payments)
- whether the discount applies to the total bill or just a part of the bill (such as the usage charge only)

- whether the discount depends on the customer agreeing to monthly billing or paperless billing
- whether the discount lasts for the life of the contract or ends after a fixed benefits period
- whether access to the discount is limited to particular types of customers
- whether there are any other inducements on offer (such as movie tickets), and
- whether exit fees apply if the customer transfers to another contract or another retailer.

None of this makes it easy for customers to navigate their way through the hundreds of contracts on offer to find the one that best, and most realistically, suits their circumstances.

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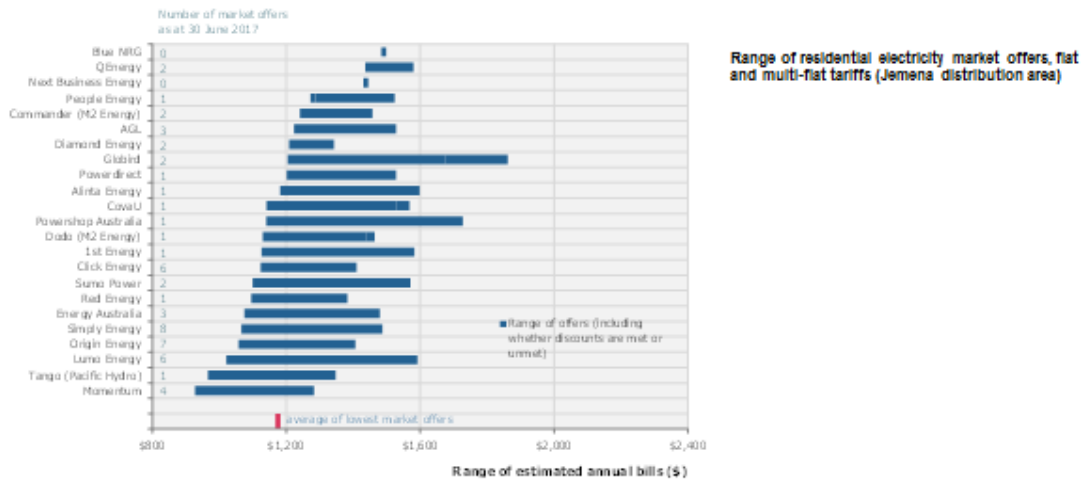
Turning now to prices and discounts...

Energy bills can vary by many hundreds of dollars and there is no consistent basis for how discounts are offered.

First, let's look at how much a typical electricity customer would pay under the numerous contracts available from each of the energy retailers.

This diagram shows that the most expensive offers were twice as costly as the cheapest offers. The cheapest offer would have seen customers paying a little over \$900 while the most expensive offer would have seen them pay over \$1800.

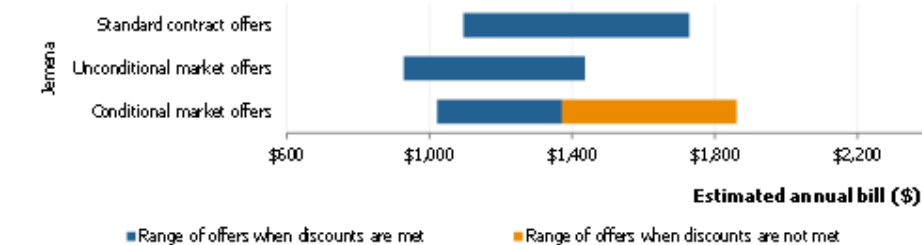
Range of electricity market prices



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Here's another way to look at what is going on in the retail energy market.

Range of electricity market prices



Range of residential electricity market offers available, flat and multi-flat tariffs (Jemena distribution area)

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This diagram separates available offers into three categories: (i) standard contracts, also known as default contracts. Historically, these were the most expensive contracts on offer, (ii) unconditional market offers – these are contracts where the price-is-the-price and it doesn't depend on whether the customer pays on time or by

direct debit; and (iii) conditional market contracts where the price paid depends on the customer meeting the retailer's conditions for a discount.

I want to highlight three aspects of this chart.

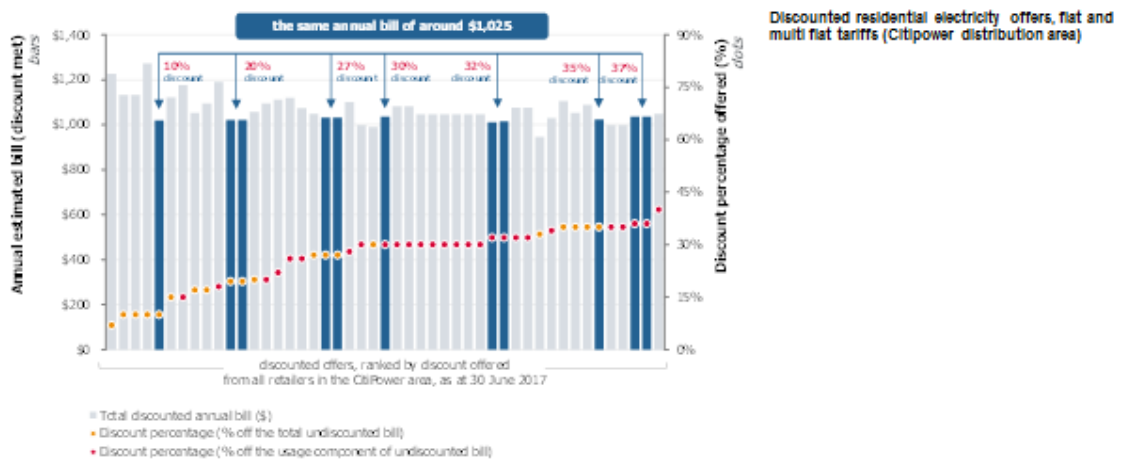
First, let's look at the conditional market offers (or the bottom bar). The blue part of the bar shows how much a customer would pay if they met the conditions. The orange part of the bar shows how much they would need to pay if they don't meet the conditions for the discount. Meet the conditions and the bill could be around \$1000, but if all the conditions of a contract are not satisfied, some retailers could charge over \$1800.

Next, you'll notice that the cheapest offers in the market (at around \$900) actually don't come with conditions. While these are the best offers in the market, we found that typically, they were only available for a limited time.

Finally, despite commonly held views, the most expensive offers in the market were not standard contracts. In fact, the most expensive contracts were conditional market offers when customer's failed to satisfy the retailer's conditions for the discount.

The last slide I want to discuss on pricing shows the relationship between how-much-you pay and the size of the advertised discounts.

Discounted electricity offers



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I find this to be a particularly disturbing snapshot of the Victorian retail energy market.

It shows how much a typical customer would pay under various discounted electricity offers. The dark blue bars show contracts where the customer ends up paying about the same amount — that is, the dark blue bars highlight 11 contracts where the customer ends up paying around \$1025 per year after discounts.

The red and orange dots show the value of the headline or advertised discount attached to each of those contracts. The orange dots show the value of discounts available off the entire bill while the red dots show the value of discounts that are only offered on the usage part of the bill.

I know it's a complicated diagram, but the bottom line is this: This diagram shows that **there is almost no relationship between the discounts being advertised by energy retailers and the amount customers end-up paying.** Or to put it bluntly: A customer on a high discount may be worse off than a customer on a low discounts even if they meet all of the retailer's conditions.

So, why is this diagram so disturbing?

It's because retailers use headline discount rates as the way they communicate with customers through their advertising. How many times, probably around dinner time, have you received a phone call telling you that, "If you switch today, you can save 30 or 35 per cent off your electricity bill?"

Over the last few years, it is this headline discount rate that has become the primary device retailers use to lure customers to switch. But as our diagram shows, **the headline discount rate has become a largely meaningless way of communicating value to customers.** And if that's the case, then how can customers readily identify which contract works best for them? And that's before we even get to all the different ways contract terms and conditions might be structured.

And here's the problem. If customers get it wrong — if they fail to understand the true value of their discounts, or if they fail to understand all the terms and conditions attached to their contract — it can cost them. It can cost them many hundreds of dollars.

Cost of not meeting the conditions for a discount

Average cost of not meeting all conditions for discounts over the year			
	2014-15	2015-16	2016-17
Electricity offers	\$193	\$246	\$314
Gas offers	\$136	\$164	\$189

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For example, if you sign up for a conditional discount off your electricity bill but you consistently fail to meet the conditions of that discounts (say, by not paying on time), it's now going to cost you \$314 more per year, on average. In other words, the

impact of consistently not paying on time, even if it's just by a day-or-two each time, will be \$314 over the course of a full year.

That compares to \$246 last year and \$193 the year before. Or put it another way, the cost of entering a contract and failing to meet the conditions has increased by 63 per cent in just two years.

And keep this in mind: these are just average figures. We found contracts where an average customer could be over \$650 dollars worse-off if they consistently failed to meet their retailer's conditions for their discounts. And the figure would be even higher for large households or households that have a poor energy efficiency rating.

So what does all this mean?

Customers need to be careful. Very careful. The highest discounts don't necessarily mean the cheapest energy bills. Not by a long shot.

I need to be absolutely clear about this. Higher discounts do not necessarily mean cheaper bills.

The market is becoming harder and harder to navigate and the consequences of getting it wrong are getting worse and worse for customers.

You shouldn't need a degree in quantum physics to buy your electricity or your gas.

Remember, whether you pay \$900 with one retailer or \$1800 with another retailer, you're still getting exactly the same electricity — and that electricity, is an essential service. As an essential service, you can't function in society without it.

Victorians are therefore right to be asking:

- How much is my electricity and gas really worth and why can't I just pay that amount?

Victorians are right to be asking:

- Why don't higher discounts mean lower bills?

Victorians are right to be asking:

- Why should I end-up paying hundreds of dollars more if I don't read the fine print when it's still the same electricity and gas?

Victorians are right to be asking:

- Why do I need to continually shop around for my electricity and gas just to avoid someone taking advantage of me?

Let me stress one point. None of these questions has anything to do with the increasing cost of electricity or gas in the wholesale market. Likewise, none of these questions have anything to do with the costs of delivering energy through poles, wires and pipelines; and the answers to these questions are unrelated to the cost of government policies or the costs of complying with regulatory obligations.

Responsibility for customer confusion rests with the energy retailers — they are the ones who sell electricity to customers; they are the ones who promote largely meaningless discounts; they are the ones who write contracts that impose terms and conditions on their customers. Retailers have created the confusion that is so evident in our report.

These are essential services. They should be the simplest purchases we make. Instead, they are amongst the most complicated.

As the regulator, I ask myself the question: Why, despite the claimed competitiveness of the market, why is the potential for customer confusion getting worse each year?

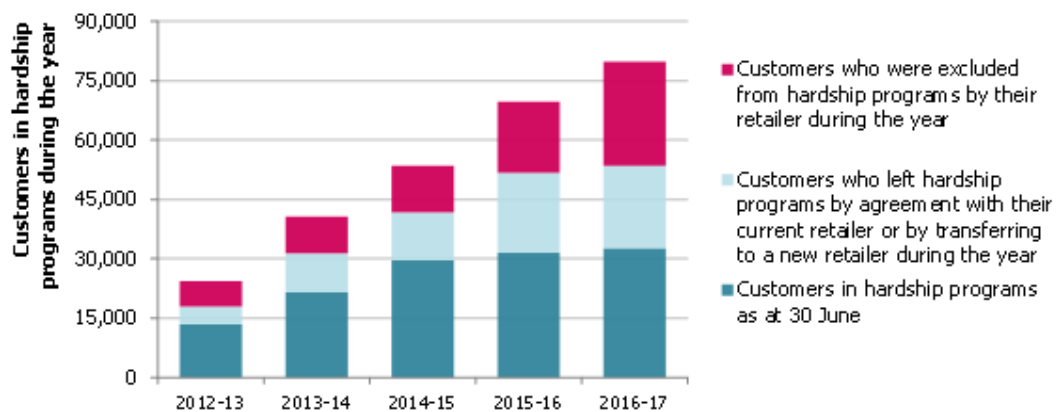
These are not acceptable outcomes. The time has come to rethink the regulatory response. That will be task ahead of the Essential Services Commission in the year ahead.

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In my last few minutes, I want to turn to what happens to customers who may be having trouble paying for their energy.

- **While the number of customers entering retailers' hardship programs continues to grow, more customers are also failing these programs.** We estimate that last year, around 80,000 customers participated in retailers' hardship programs at some stage. This is the highest number of estimated participants since we started collecting data (and probably the highest number ever).

Customers in hardship programs



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At the same time, however, the number of customers who were exited from (read: thrown out of) their retailer's hardship program has increased significantly over the last few years. As you can see from this diagram (the pink blocks), about one third of customers who are, or had been, in a hardship program in 2016-17, were no longer in the program because they failed to meet their retailer's requirements.

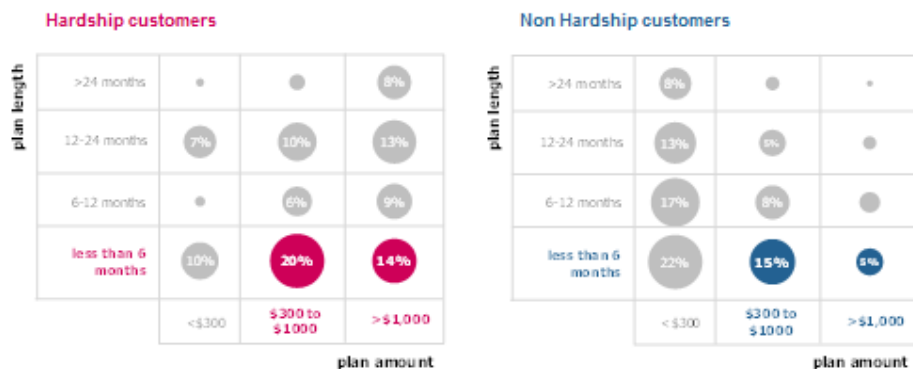
So, why might this be happening?

I'd like to posit two possible explanations.

- First, payment plans are the most widely used form of assistance that retailers offer to customers who may be facing difficulty paying their bills. Only a quarter of customers on a payment plan will also be enrolled in a retailer's hardship program. That allows us to compare the debt levels of customers on payment plans who are in hardship programs with the debt levels of customers who are not in hardship programs.

Customers on instalment plans

Breakdown of customers with instalment plans, by plan length and amount



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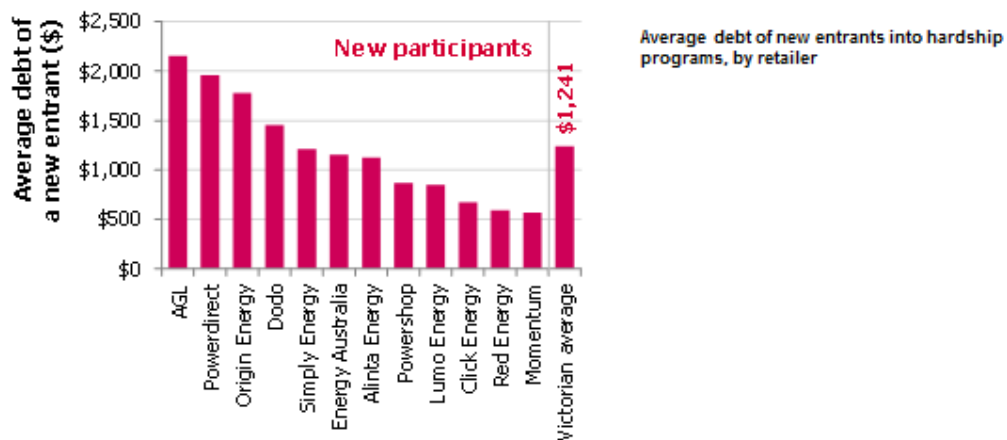
This is a difficult diagram to take in. It took me a while to realise the profound significance of what it is telling us.

What it is showing is that retailers are expecting hardship customers on payment plans to repay higher levels of debt than other customers on payment plans of similar lengths. Or to put it another way, **it is suggesting that retailers are expecting hardship customers to repay their debts more quickly than other customers.** This is despite hardship customers self-evidently facing more profound levels of payment difficulty than other customers.

It beggars belief that customers in hardship programs are required to repay their debts faster than other customers.

- The second reason I believe so many customers are failing retailers' hardship programs has to do with the level of debt customers are accumulating before they're even offered access to those hardship programs.

Average debt on entry to hardship programs



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This diagram highlights the average level of debt of new entrants into retailers' hardship programs — that is, how much debt customers have accumulated before being offered a place on a hardship program. In 2016-17, the average level of debt accumulated by a customer before gaining access to a retailer's hardship program was \$1,241. Some retailers only provided access to their hardship programs when the customer had debts of around \$2,000.

To put this into perspective, this \$1,241 is not too different from what a typical household might have expected to pay for their electricity or for their gas in 2016-17.

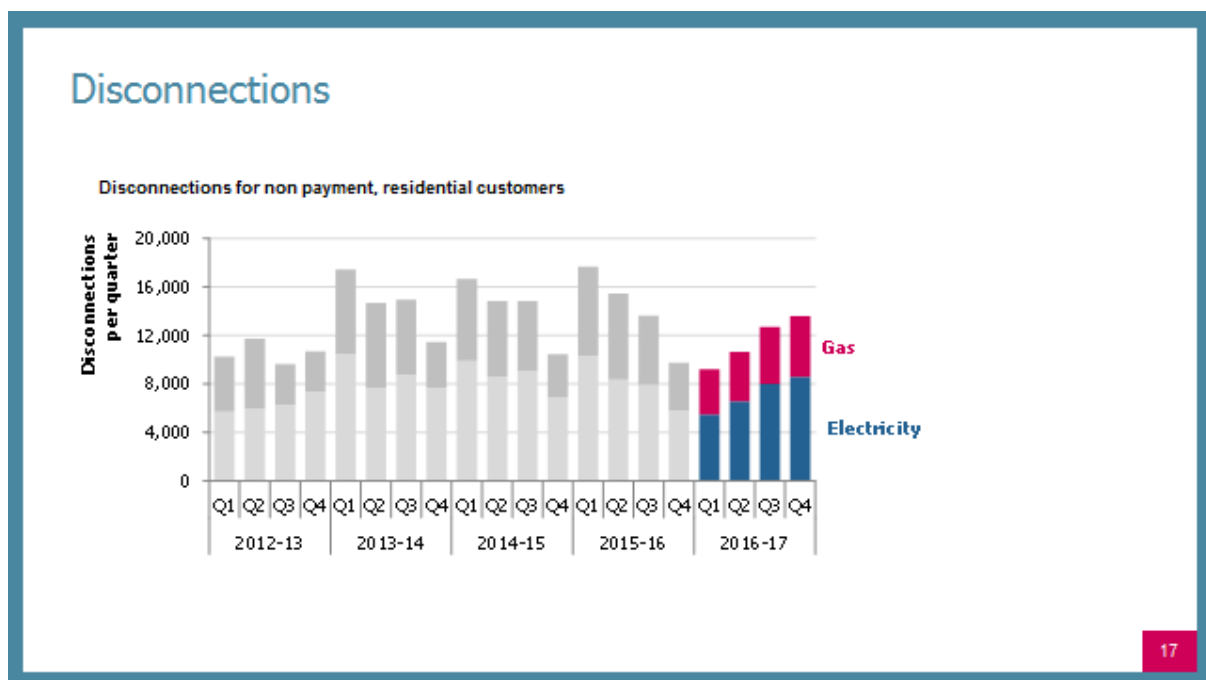
In other words, it would seem that retailers are often intervening to support customers with hardship assistance only after the customer has gone for about a year without paying their bills. This means customers are already a year behind before they even enter a retailer's hardship program.

Perhaps, we should not be surprised at the increasing failure rate of retailers' hardship programs reported in this year's *Victorian Energy Market Report*. It would seem that, too often, **retailers are waiting too long before offering customers access to their hardship programs — potentially dooming many of these customers to failure from the outset.**

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Finally, let me turn to disconnections — that is, how many customers are having their energy cut-off by their retailer for not paying their bills?

- **In 2016-17, around 50,000 customers were disconnected from their electricity or gas supply.** This was a notable decline on the previous year when there were around 61,000 disconnections for non-payment. Unfortunately, however, the story doesn't end there. A closer look at the data reveals that while disconnections steadily declined last year, the reverse was true this year with disconnection rates steadily increasing. If the trend continues then the quarterly number of disconnections could soon reach previous highs.



These findings about hardship programs and disconnections are disheartening. They show little has really changed since we held our inquiry into hardship arrangements over two years ago. Of course, some retailers perform better than others — I want to acknowledge that explicitly — but overall, the need for reform we identified in 2015 is as urgent today as it was back then and perhaps, more so.

That's why the comprehensive package of reforms to assistance arrangements we announced last month are more needed than ever.

Our new payment difficulty framework establishes new and clear customer entitlements to minimum standards of assistance from their energy retailers. At the same time, we will hold retailers to account for providing timely, flexible and meaningful assistance to customers who are facing payment difficulty. The new framework represents a 'once in a generation' overhaul of the energy rules. It comes into effect on 1 January 2019.

In the meantime, we will monitor developments in the Victorian energy market including retailers' readiness for the new payment difficulty framework. We will publish our findings on a quarterly basis.

The Victorian government has indicated it will respond to the recommendations of the *Independent Review of the Electricity and Gas Retailer Markets in Victoria* (the 'Thwaites review') by the end of this year. This may alter our functions and powers in relation to the Victorian energy market. We will use our quarterly updates to report on any relevant developments — and where appropriate, we will consult on the changes being pursued.

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Our goal is to make the *Victorian Energy Market Report* a definitive and trusted source of information for all Victorians. We welcome any feedback on this year's report and whether there are any particular matters you would like us to explore in future reports.

Thank you for your attendance today.

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