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12 April 2022

Ms Kate Symons
Chairperson
Essential Services Commission

By email: VDO@esc.vic.gov.au

Submission to the Essential Services Commission on the Victorian Default Offer 2022-23 Draft Decision

Dear Kate

Energy Consumers Australia welcomes the opportunity to comment on the Essential Services Commission's (ESC) draft decision on the Victorian Default Offer (VDO) 2022-23.

We support the proposed continuation of the current approach to setting the VDO. We believe this approach has safeguarded consumers on standing offers from unjustifiably high prices, and will continue to do so into the future.

However, we believe there is room for the ESC to investigate further improvements without compromising the benefits that exist for consumers who are engaged in the market:

- We echo the views made by Consumer Action Law Centre (CALC)[1] and Victorian Council of Social Service (VCOSS)[2] in consultations for previous decisions that there should be steps taken to avoid information asymmetry and "cost-stack creep" in the calculation of retail costs.

  To account for the information asymmetry, we suggest the application of a productivity factor on retail costs to account for the likely efficiency gains that would be achieved by an efficient retailer.

- We consider there is scope for lowering the retail margin to remain in line with regulatory decisions in ACT and Tasmania.

Please see the below to understand the reasons for our position below.

The current approach to setting the VDO achieves its goal of protecting consumers

We support the continuation of the current approach to setting the VDO. We believe the VDO has achieved its policy objective of protecting consumers from unreasonable prices, evident by both market and standing offer prices decreasing since the introduction of the scheme.[3]

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[1] CALC, *Submission to the 2022 Victorian Default Offer consultation paper*, June 2021, p. 3.
[2] VCOSS, *submission on the ESC's Victorian Default Offer 2022 approach consultation paper*.
[3] St Vincent de Paul Society, *The NEM – Lower prices, more offers: Are consumers reaping the rewards?*, November 2021, p. 21.

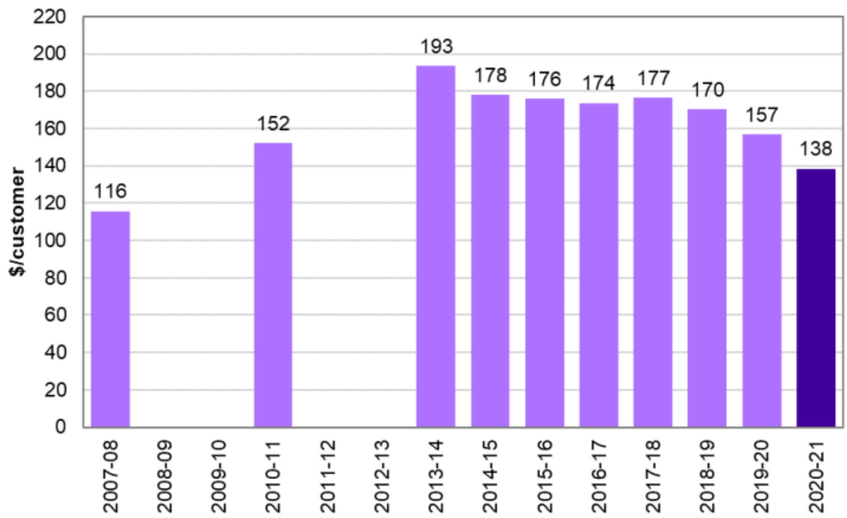
In our submission to the AER as part of their consultation process for the Default Market Offer, we provided an extensive analysis of the level of competition in the Victorian retail energy market. It shows that there is significant retail competition and ample choice for consumers in Victoria. There are 25 separate retailers operating in each of the network areas, with the majority of these retailers offering prices well below the VDO[4]. The strong level of competition is evident in the fact that a greater proportion of Victorian customers are on market contracts than in other jurisdictions[5].

The inclusion of a productivity factor would address information asymmetry issues

The current mechanism allows retailers to report when costs have increased however provides little incentive to report reduced costs. We agree with previous submissions[6] that we should be cautious of the potential for a "cost-stack creep" when determining the VDO.

We would expect an efficient retailer would become naturally more efficient over time, leading to reductions in certain costs. This is confirmed by Australian Competition and Consumer Commission (ACCC) data which shows a multi-year trend in declining retail costs for both small business and retail customers (see Figure 1 below)[7]. With the information asymmetry that exists in the current approach, there is the potential that these improvements in efficiency are not passed on to consumers. This goes against the policy objective to provide a simple, trusted and reasonably priced offer for disengaged consumers[8].

Figure 1: Average retail and other costs over time per residential customer across the NEM



Source: ACCC Inquiry into the National Energy Market November 2021

[4] St Vincent de Paul Society, *Victorian Energy Prices*, January 2022, p. 12.
[5] ACCC, *Inquiry into the National Electricity Market*, May 2021, p. 18.
[6] CALC, *Submission to the 2022 Victorian Default Offer consultation paper*, June 2021, p. 3 *and* VCOSS, *submission on the ESC's Victorian Default Offer 2022 approach consultation paper*.
[7] ACCC, *Inquiry into the National Electricity Market*, November 2021, p. 30.
[8] Clause 3, Order in Council made under Section 13 of the Electricity Industry Act 2000, No. 208 Thursday 22 May 2019.

As also suggested in other submissions[9], the application of a productivity factor to the retail cost component would address these information asymmetry issues and ensure that reductions in retail costs are passed on to consumers. We note that this was considered in previous rounds of consultation but was decided to not be included due to uncertainty associated with the pandemic[10]. We believe that there is now scope to revisit the introduction of a productivity factor.

The current retail margin could be reduced to remain aligned with other jurisdictions

The draft decision continues with the 5.7% retail margin that has been used for previous determinations. We consider this should be reduced in the final decision.

The draft decision has indicated the overall price of the VDO will rise for 2022-23. Given the margin is determined as a percentage of total costs, this results in an increase in the dollar value of the retail margin. This further emphasises the need to continually assess whether a 5.7% margin remains an "efficient" level.

In the ACT, the Independent Competition and Regulatory Commission (ICRC) reduced the retail margin in 2017 in response to increased energy purchasing costs to ensure it remained at a "reasonable" level[11]. As prices rise in the Victorian market, we believe it is appropriate for the ESC to consider a similar approach.

As we have already demonstrated, the current approach to setting the VDO has not had a detrimental effect on the choice available to market offer customers, with the majority of retailers' market and standard offers well below the VDO. Therefore, we believe there is room for the ESC to consider a lower retail margin to maintain a VDO that reflects "efficient" costs.

We note the margin was determined through a benchmarking approach which considered the margins used by regulators in other jurisdictions with regulated standing offers. According to the draft decision, the latest regulatory decisions ranged between 5.4% and 5.7% therefore placing Victoria in the upper end of this range[12]. We also note, however, that the ACT currently uses a 5.3% retail margin.

We agree with previous submissions made by CALC[13] raising concern about the reliance on regulatory decisions in other jurisdictions when setting the retail margin. There is the possibility that this approach could become circular and, by not considering the methods involved in setting these initial margins, there is the potential that it is no longer relevant to current determinations.

If you have any questions about our comments in this submission, or require further detail, please contact Ashley Bradshaw by email at ashley.b@energyconsumersaustralia.com.au.

Yours sincerely,

Jacqueline Crawshaw,
Director, Energy Services and Markets
Energy Consumers Australia

[9] CALC, *Submission to the 2022 Victorian Default Offer consultation paper*, June 2021, p. 4 and VCOSS, *submission on the ESC's Victorian Default Offer 2022 approach consultation paper*.
[10] ESC, *Victorian Default Offer 2021 Draft Decision*, September 2020, p. 23
[11] ICRC, *ICRC Retail electricity price investigation 2020-24*, June 2020, p. 49.
[12] ESC, *Victorian Default Offer 2022-23: Draft decision*, March 2022, p. 29
[13] CALC, *Submission to the 2022 Victorian Default Offer consultation paper*, June 2021, p. 3.