

Getting the VDO right

Joint submission to the Victorian
Default Offer Review 2024-2025



DECEMBER 2023

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

This a joint submission made by the Victorian Council of Social Service, the Brotherhood of St. Laurence, Consumer Action Law Centre, Council of the Ageing Victoria, Energy Consumers Australia, Financial Counselling Victoria, and Good Shepherd. 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 Victorian Default Offer has proven itself as a safeguard for Victorian consumers

We believe that the Victorian Default Offer (VDO) has provided an important safeguard for consumers that are unable or unwilling to engage with the electricity retail market, a key benchmark price for market offers, and since September 2020, a crucial maximum price for embedded network customers. Taken together, VDO customers and those on embedded networks number over 400,000 households, businesses, and individuals.¹ We strongly support the VDO playing these roles and believe it should continue to do so, while being kept at the lowest reasonable price.

The VDO has also been successful in eliminating excessively priced standing offers from the market. As a reference price, the VDO has made it easier for consumers to compare alternative market offers and deterred misleading discounting practices.

Alongside the VDO, Victorians continue to have access to a robust retailer market, with competitive market offers and new retailers regularly entering the market. As such, historic concerns by retailers that the VDO would stifle market participation or product innovation have proven wholly unfounded.

However, given that the Essential Services Commission (ESC) has proposed to use generally the same methodologies as in past reviews for the 2024-2025 period, our submission identifies where there remains work to be done, and VDO cost-stack components where key assumptions and choices should be reconsidered.

¹ Essential Services Commission (2023). *2024-25 Victorian Default Offer: Request for Comment*, pp1-2

The ESC should encourage retailers to assist VDO customers onto cheaper offers

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.

In 2022–23, 13.6 per cent of Victorian consumers were on the VDO, up from 11.9 percent in 2021–22.² Approximately 20 per cent of small business consumers were on the VDO in 2022–23, this is up from around 17 per cent in 2021–22.³

Given this trend, the ESC should ensure that retailers are fulfilling their regulatory obligations to offer customers the best market offer, and support efforts such as the Energy Assistance Program.

As volatile wholesale prices settle, the VDO will be an important mechanism for passing on cheaper prices to customers

Volatile wholesale costs were primarily responsible for large increases in price – 25 per cent on average – of the VDO in the last pricing decision.⁴ These increases mostly stemmed from the cost of fossil fuels skyrocketing in the wake of international events such as the Russian invasion of Ukraine in 2022.

As international markets settle and increasing amounts of renewable generation come online in the grid, these wholesale costs should continue to come down. In this context, the VDO will prove an important mechanism for ensuring those savings are passed on. In this sense the VDO aligns with broader Victorian Government policy settings around wholesale investment.

We urge the ESC to ensure pricing methodologies adequately capture and reflect any future reductions in wholesale electricity prices.

The ESC should reconsider customer acquisition and retention as part of the retail operating cost

It is unfair for customers on the VDO to have the costs passed on to them of acquisition channels (such as third-party comparison websites or telemarketing), retention teams, and marketing costs targeted at driving customer acquisition or retention. Customers on the VDO are there because they are not on a market offer, not because they have come to the retailer due to any acquisition or retention activities. Many customers will in fact be on the VDO because retailers have failed to provide adequate guidance onto better priced offers.

2 Essential Services Commission (2023), *Victorian Energy Market Report: September 2023*, pp39-40.

3 Ibid.

4 Essential Services Commission (2023), *Victorian Default Offer 2023–24: Final Decision Paper*, p3

Embedded network customers should effectively have no acquisition or retention costs because they cannot change retailers.

In this context it is unfair to expect customers on the VDO to pay the costs for customer acquisition and retention. In the previous pricing determination for the VDO for 2023-2024, the ESC acknowledged this fact, stating: "... the benefits provided to customers [by acquisition activities] are unclear. Some customers that receive special acquisition deals may benefit, but overall customers are likely to be worse off as total costs increase."⁵

We recognise that the ESC does not have the power to remove customer acquisition and retention from the pricing determination, however we urge the Commission to ensure that these costs are kept at a modest level in line with the VDO Order in Council.

With this in mind, we also urge the ESC to advise the Minister to remove customer acquisition and retention costs from the Retail Operating Cost portion of the VDO.

The Retail Operating Margin should be reduced to reflect actual retail margins and to bring it in line with other jurisdictions

We believe the benchmark of 5.3 per cent to be overly generous. The ESC's previous pricing determination observed that average actual retail margins across Victorian retailers had been decreasing per customer since 2017.⁶ The final determination also noted that other regulators have set margins as low as 3.9 per cent.⁷

We urge the ESC to reassess the benchmark used to determine the retail operating margin portion of the price stack and bring it into line with other jurisdictions.

Pricing determinations for the VDO should be considered in the broader context of the cost of living

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.⁸ Once gas customers in hardship are included, we see that more customers accessed tailored assistance in 2022-23 than any financial year since the commencement of the Payment Difficulty Framework.⁹ Customers

5 Essential Services Commission (2023), *Victorian Default Offer 2023-24: Final Decision Paper*, p41

6 Ibid, p53.

7 Ibid, p49.

8 Essential Services Commission (2023), *Victorian Energy Market Report:2022-2023*, p7

9 Essential Services Commission (2023), *Victorian Energy Market Report: September 2023*, p28.

are also spending longer on tailored support and are more often leaving that support still in arrears, this indicates worsening affordability and increased risk of disconnections.¹⁰

Energy Consumers Australia's recent Energy Consumer Sentiment Survey found that 51 per cent of households were more concerned about their ability to pay their electricity bills than they were a year ago, among households that identify as being under financial pressure this rises to 82 per cent.¹¹ The survey found almost a third of households have either reached out to their retailer for help in the past year or expect to do so in the near future.¹²

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 2023.¹³ This broader increase is coupled with the 25 per cent increase in last year's VDO from the previous year.¹⁴ 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 deaths¹⁵ – 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.

To that end, we suggest 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.

10 Essential Services Commission (2023), *Victorian Energy Market Report:2022-2023*, p8-9

11 Energy Consumers Australia (2023), *Sentiment Survey: December 2023*.

12 Ibid.

13 Australian Bureau of Statistics (2023), *Consumer Price Index, Australia, September Quarter 2023*.

14 Essential Services Commission (2023), *Victorian Default Offer 2023–24: Final Decision Paper*.

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*.

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.

Recommendations:

1. **Maintain.** 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. **Enforce.** The ESC should ensure that retailers are fulfilling their regulatory obligations to offer customers the best market offer, and support outreach efforts such as the Energy Assistance Program.
3. **Respond.** The ESC must ensure that any reductions in wholesale electricity prices are reflected in VDO pricing determinations.
4. **Remove.** Customer acquisition and retention costs should be kept to a modest amount, and the ESC should advise the Minister to remove this portion of the pricing from the Retail Operating Cost portion of the VDO.
5. **Reduce.** The Retail Operating Margin should be reduced in line with other jurisdictions.
6. **Select.** 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.
7. **Understand.** Across all essential services, the ESC should work to embed an understanding of the cost of living into all determinations.