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29 April 2022

Review of the Victorian Default Offer Order in Council

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Review of the Victorian Default Offer Order in Council Consultation Paper ('Consultation Paper').

The Energy Council is the industry body representing 20 electricity and downstream natural gas businesses operating in the competitive e wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to over ten million homes and businesses, and are major investors in renewable energy generation.

The Victorian Default Offer ('VDO') has been in operation since July 2019. Alongside the Default Market Offer ('DMO') in the NECF states, it was introduced as a means of price regulation to address unreasonably high standing offers. As both policies have only been in force for a short period of time, it is difficult to assess what impact they have had on the market. Nonetheless, based on the preliminary findings in this Consultation Paper, the AEC acknowledges that some of its previous concerns about price regulation hurting the competitive market have been avoided to date. This outcome has been helped in part due to the VDO currently only having operated in a period of relative stability in wholesale and network prices. As the market becomes more volatile in the coming years, the ability of the Essential Services Commission ('ESC') to continue to set a fair VDO will be critical to its ongoing impact on the market and Victorian consumers.

It is hoped the VDO can continue to be regulated in a manner that maintains or improves the competitive market and recognises that healthy competition delivers better outcomes for customers.

1. Does the retail data for residential and small business customers demonstrate that the policy objective of the VDO (to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market) is being achieved?

The retail data shows that the VDO has reduced the price of standing offers in the market. To the extent this was the intended objective of the VDO, then this was achieved in 2019 with the introduction of the first VDO.

However, it is less clear whether the data shows the stated objective (that is, to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market) is being achieved. This stated objective appears to indicate that the VDO would become an offer that customers might opt into – that is, because of a lack of trust in the market, they might choose to opt onto an offer that was set by the government as an alternative to engagement. The AEC does not consider there is any evidence to suggest this is occurring. As noted in the paper, Victoria has the lowest number of consumers on the VDO, despite it being the cheapest regulated price in the NEM. This indicates that customers are not in fact seeking out a regulated price, but rather, they are unintentionally benefiting from being placed on one. This outcome might be welcome, but it does not suggest that the VDO is meeting its stated objective.

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The DMO, on the other hand, has a clearer objective. The DMO sets out to 'reduce unjustifiably high standing offer prices and continue to protect consumers from unreasonable prices'.[1] The AEC considers that this DMO objective would also align with the Victorian Government's intended VDO objective.

However, positing the VDO as an offer that customers might wish to "opt into" is confusing its function within the market. The AEC considers it unlikely that many customers would choose to sign up to the VDO if they were aware that market offer prices have to date been significantly cheaper. There is a risk then that the Victorian Government's messaging about what the VDO is and how it might benefit customers is discouraging participation in the market, to customers detriment. In this sense, the stated objective is likely resulting in customers remaining on the VDO unnecessarily. While the AEC agrees that customers should not be unreasonably impacted by disengagement, it is our view that engagement with the retail market should always be encouraged for customers who are able to. This engagement benefits customers at the time of sign up through a cheaper energy deal and helps foster a relationship between the customer and retailer, which is particularly important when a customer is experiencing financial difficulty.

On the importance of building positive relationships between the retailer and customer, the Review should consider whether some of the regulator's rhetoric aligns with the VDO's objective to build trust in the market. The portrayal of retailers as antagonistic to the interests of consumers unless compelled by the regulator makes it difficult for trust and collaboration to develop.

2. Has the introduction of the Victorian Default Offer affected competition in the retail market?
When the VDO was being originally considered, many industry stakeholders, including regulatory bodies such as the Australian Energy Market Commission ('AEMC'), cautioned that price regulation could have distortionary and negative impacts on retail competition. Concerns were raised specifically around less price dispersion, increased barriers to entry, and risks to innovation. The AEC acknowledges that, to date, some of these concerns have not yet materialised. While this is encouraging, this short-term outcome should not be treated as conclusive evidence that the well acknowledged risks around price regulation will not emerge in the future.

The AEC also notes that the last three years are a difficult barometer to use to determine the impact, positive or negative, of price regulation due to the extraordinary events that have unfolded. The ongoing coronavirus pandemic led to government, regulators, and retailers, all implementing a suite of exceptional rules and support packages to ensure customers received the support they needed. As circumstances start to revert to normal or the "new normal", there is uncertainty about what delayed impacts these support measures might have, not only in the energy sector, but across the broader economy.

Overseas, for example, the United Kingdom has experienced a major retail market crisis with many suppliers defaulting. This crisis was unexpected as many ordinary indicators of competition, such as the number of retailers competing in the market, was high and growing, which was taken as evidence that price regulation was not posing a barrier to entry. The major triggers of the retail market crisis were skyrocketing wholesale (gas) prices, with hedging challenging in part due to an artificially low price cap, and retailers with unsustainable business models. The AEC is not suggesting that circumstances are directly comparable to here – while Australia is also witnessing exceptionally high wholesale prices, Australian regulators are more stringent when it comes to licensing new retailers.

[1] Australian Energy Regulator, Default Market Offer Prices, Options paper on the methodology to be adopted for the 2022-23 determination (and subsequent years), 25 October 2021, p10

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Rather, as the disruption of the coronavirus pandemic is ongoing, and there are signs of delayed impacts starting to emerge (e.g. wholesale price spikes, inflation leading to greater cost-of-living pressures), the AEC encourages this Review to avoid being too conclusive when relying on the past three years as a reliable indicator of the future.

3. Has the Victorian Default Offer reference price improved transparency in the retail market?
The AEC agrees that the obligation to refer to the VDO as a reference price has improved transparency in the market. Industry supported this obligation prior to its introduction, and whilst there are some challenges with its practical operation, it is beneficial overall in today's retail market.

That said, as with the DMO reference price, the AEC consider that its utility is time limited. The VDO reference price is a highly simplified price comparison designed to reach the maximum number of customers. With that reach comes an entirely generic price comparison that is not personalised in any way to individual customer circumstances. As the availability of data increases – both using direct-to-consumer portals such as Victorian Energy Compare's "download your data" feature, and the introduction of third-party access via the Consumer Data Right, the benefits of continuing to require retailers to publish the generic reference price will decrease. The AEC notes that the Federal Government has committed to re-evaluating the role of the reference price two years post the implementation of the Consumer Data Right in energy to ensure it remains effective.

The reference price also creates other challenges. While comparison with "basic" offers is possible, it is less so with more innovative offers. As retailers and customers look to take of advantage of Distributed Energy Resources in Victoria, there will be a need for the reference price to be scaled back to allow this innovation to occur. As noted above, the reference price is generic and requiring retailers to present this information when they are entering into more complex "tailored" energy arrangements with engaged consumers is unhelpful. The AEC encourages the Government to consider approaches that might expand the exemptions framework to mitigate the impacts on innovation, in a manner that does not unreasonably reduce the benefits the reference price currently provides most customers today.

4. Has the Order covered all customer groups that should be able to access the Victorian Default Offer?
Yes, the AEC considers the scope of the VDO to be adequate.

5. What more could be done to encourage market participation by customers on higher priced market offers?
Supplementing the introduction of the VDO was a suite of major reforms, as recommended via the Thwaites Review, to improve customer outcomes. This included the provision of fact sheets, best offer notice, clear advice entitlement, and rules relating to clear and fair contracts. These reforms commenced throughout 2019 and 2020 so it is again difficult to assess their impacts, due to how recently they were implemented, and the extraordinary circumstances during this time. The AEC would encourage the Review to allow adequate time to see the effects of these reforms before considering new policies.

If a new policy is being considered, then the ESC should first consult to ascertain the extent of this problem. This should include attempting to quantify the number of legacy market contracts, the type of customers on these contracts, how it could affect customers on non-legacy contracts, and then ultimately what actions could be taken and whether the benefits of each action outweigh the costs.

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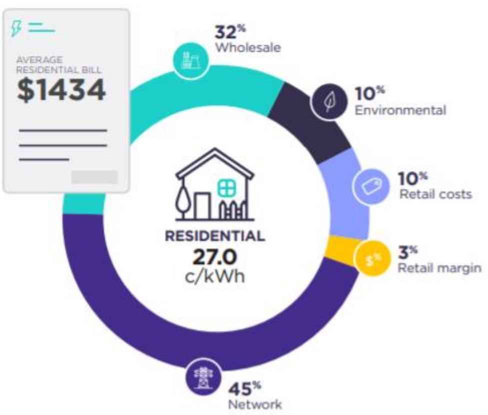
6. Does clause 12 of the Order in Council provide the ESC with an appropriate level of discretion when undertaking a VDO pricing determination?
It is difficult to comment on this question because it is not clear what level of discretion the ESC has when undertaking its responsibilities. The AEC would support the ESC publishing guidance on how it interprets the scope of its discretion, including on to what extent there is discretion to expand or deviate from previous methodologies used. That said, to date the AEC considers that the ESC has done a good job in assessing the need to include allowances for unusual or changing market circumstances. While we do not always agree with the regulator in how they assess costs, it does appear that they have adequate discretion in their ability to consider the costs facing retailers.

7. Are there other factors that the ESC should have regard to when carrying out VDO pricing determinations?
The ESC should begin considering how the VDO aligns with future market changes, many of which retailers have minimal control over yet are directly impacted by. This includes most notably the shift towards renewable and less centralized generation like community batteries and Virtual Power Plants, and increased uptake of distributed energy resources, as envisaged in the Energy Security Board's P2025 Review. The level of discretion described in question 6 should be considered in light of this impending challenge.

The greater customer participation that these changes seek to bring will create both opportunities and challenges for the retail energy market, and retailers will need to adjust their services to give customers value and maintain their existence. It is important the VDO does not inadvertently impair the ability of retailers to innovate and adapt, as this will have flow-on effects on customer participation.

8. How can the Order in Council best take account of retailers' variable expenditure on customer acquisition and retention?
While the AEC is aware that the ESC is under pressure from some stakeholders to squeeze, if not altogether remove, customer acquisition and retention costs ('CARC'), this is based on the misguided belief that these costs are large and unreliable. The graphs below, sourced from the ACCC's November 2021 report, illustrate clearly that retailer costs are a very small cost input on the electricity bill.



To this end, reducing CARC as a policy objective of the VDO is unlikely to deliver any positive outcomes to Victorian customers. The AEC does not consider it to be good regulatory policy for CARC to be reduced simply based on the grounds that it is a 'difficult input to accurately assess'. The Review should instead consider to what extent, if any, a median provision of CARC would result in a less efficient VDO, and whether the trade-offs of allowing a CARC allowance (e.g. greater customer churn)

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benefit customers. The Review may wish to consider whether the CARC data contained in the ACCC report cited above can help inform the assessment of CARC.

The AEC does not consider that recent Energy Fairness Plan reforms materially impact CARC. Larger retailers had already stopped door-to-door sales to residential customers almost one decade prior to the ban. Retailers that did rely on these sales strategies have adjusted to new sales channels and it is unclear at this early stage whether these new strategies will reduce, or increase, reasonable CARC.

11. Has the consultation processes utilised by the ESC under clause 14 of the Order provided stakeholders with an effective means by which to provide feedback on VDO price determinations?
The AEC considers that the ESC’s approach to consultation has been robust and largely allows stakeholders to provide feedback effectively. That said, there have been challenges on both the ESC and industry to provide genuinely informed input to these processes due to extremely tight timeframes imposed by the regulator. In future determinations, the AEC strongly encourages the ESC to allow industry at least six weeks to respond to draft determinations. These draft decisions contain real cost projections that are unable to be effectively scrutinised within a four-week consultation period.

Further to this, as the wholesale market is showing signs of volatility, partly spurred by the announced earlier closure of coal-fired generation and other external factors, the AEC considers that the inputs Frontier Economics relies on to estimate the wholesale cost should be revisited and consulted on. This will give stakeholders confidence that the methodology used is resilient to the energy transition and future market changes.

13. Is there anything else you would like to raise about the operation of the Order in Council?
As a general observation, reviews like the one here, while serving an important accountability function, often feel compelled to make recommendations to justify their existence. This can lead to paradoxical situations where the consultation paper concludes that a policy has been successful in meeting its policy objectives, but then also significant changes are recommended, which would imply the policy is not working as intended.

If this Review does opt to make major recommendations, the AEC recommends these first be released as part of a draft report to allow stakeholders to consult and provide feedback on their merits and inform the final report.

The Review may also wish to consider the viability of eventually harmonising the VDO and DMO. Now that both policies have close to aligned methodologies, the policy reasons for keeping them distinct are less apparent. An aligned approach would significantly reduce regulatory burden and customer confusion, and should not compromise the respective policy objectives.

Any questions about this submission should be addressed to Rhys Thomas, by email to Rhys.Thomas@energycouncil.com.au or by telephone on (03) 9205 3111.

Yours sincerely,

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