AUSTRALIAN ENERGY COUNCIL

Environment, Land, Water and Planning
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1 May 2019

**Victorian Default Offer: Draft Orders**

The Australian Energy Council (the **'AEC'**) welcomes the opportunity to make a submission regarding the Department of Environment, Land, Water and Planning **('DELWP')** Draft Orders (the **'Draft Orders'**). The Draft Orders implement the Victorian Default Offer (**'VDO'**) under section 13 of the *Electricity Industry Act 2000*.

The AEC is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The AEC has previously contrasted the different approaches being taken by Australian Energy Regulator **('AER')** and the Victorian Government in implementing a default offer. The Australian Energy Regulator has adopted a cautious approach to the initial setting of its Default Market Offer **('DMO')**, with a view to analysing its impact on the market and revising that methodology in the future. The Victorian Government, on the other hand, has chosen an approach that will have considerable negative impact on the effectiveness of the competitive market. This contrast in approach has been evidenced in two independent reviews of the VDO; an independent analysis by KPMG on the cost stack method, and an independent assessment by Craig Emerson of Emerson Economics **('Emerson')** on the departures from conventional economic principles. The AEC has previously urged that a similarly cautious approach to the DMO be taken in setting the VDO, particularly to avoid having to revise up the VDO price for 1 January 2020. The AEC maintains it would be prudent, in terms of market and customer impacts, to introduce the VDO at a more moderate level in the first instance.

The implementation timeframe in which the Government is seeking to introduce the VDO is very compressed. If the Government is, as we assume, committed to delivery on 1 July 2019, it must consider a staged implementation of the additional requirements of the Order in Council. This is required to allow retailers to make systems changes, communicate with customers and, critically, train call centre staff to deal with enquiries from 1 July 2019. We note the considerable systems upgrades that retailers are already undertaking for 1 July 2019 where the Government allowed nine months for implementation, pursuant to

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the Victorian Government's response to the Independent Review[1], compounds the cost and difficulty in implementing further last minute changes.

**Reference Pricing**

The draft Order in Council requires retailers to use the VDO as the reference price for discounted offers. There are likely to be unintended consequences through rushing implementation of this highly complex change, requiring retailers to use the VDO as the reference price for discounts. There is a real risk that as currently drafted, it has the potential to confuse customers and at worse mislead them. Though the drafting is not entirely clear, the draft Order in Council appears to require that a retailer that chooses to offer a discount or other benefit may only characterise that discount or benefit by reference to the VDO price. This presents problems where a retailer's base prices or tariffs are not identical to the VDO.

AEC members have also identified that the regulatory changes to reference pricing require retailers in some circumstances to fundamentally change their product offerings and the way those offers are presented. In particular, the advanced price change notification requirements that would need to be provided to customers five business days before the VDO takes effect are impacted.

**Key questions for feedback (questions provided by DELWP)**

The AEC and AEC retailer members met with DELWP on 16 April 2019 to provide feedback and obtain clarification on the draft orders. This submission broadly reflects those discussions, but also includes further issues that have been subsequently identified.

**1. Is the objective in Clause 3 of the draft section 13 Order clear and appropriate?**

The objective in Clause 3 does not include any reference to the competitive market. The AEC is concerned that this makes it inconsistent with sections 8 and 8A of the *Essential Services Commission Act 2001*, which require the Essential Services Commission **('ESC')** to have regard to various matters in performing its functions, foremost being the long term interests of consumers, an objective supported by such considerations as the degree and scope for competition within the industry. We note that the ESC considered that the VDO should operate without impeding the consumer benefits experienced by those who are active in the market.[2]

We recommend that the original reference from the terms of reference provided to the ESC in relation to competition be added into the objective in clause 3.

**2. Does Clause 6 of the draft section 13 Order adequately give effect to the VDO for the initial period from 1 July 2019 to 31 December 2019?**

Clause 6 does not make it clear that a retailer, if requested, must put a non-flat Standard Offer customer onto a flat tariff VDO. If it is the objective that customers on non-flat Standing Offer tariffs should also be offered the flat VDO if the customer requests it, then this creates consequential issues with retailers needing to request and obtain network tariff reassignment from the distribution network business.

[1] Independent and Bipartisan Review of the Electricity and Gas Retail Markets in Victoria.

[2] Essential Services Commission, Victorian Default Offer to apply from 1 July 2019 — Draft advice, 8 March 2019, p. 10.

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To address this, the AEC recommends concurrent changes to the Advanced Metering Infrastructure (AMI) Tariffs Order to give adequate and practical effect to the VDO, requiring that a distributor must assign a small customer onto a flat VDO *distribution* tariff when directed by a retailer. This is consistent with the Victorian Government's existing consumer protection that exists for customers that opt in to and out of a flexible pricing tariff. The AEC is confident that the Victorian Government does not want to introduce any deterioration in consumer protections as a result of the introduction of the VDO.

Minor correction is required at Clause 6.4 references sub-clauses (1) and (2). We believe that this should be corrected to subclauses (2) and (3).

**3. Does Clause 9 of the draft section 13 Order appropriately reflect the objective of the VDO?**

In our experience the 42-day period to introduce a price determination does will not leave sufficient time for retailers to incorporate network prices as well as determine and then publish their standing offer prices. This is historically because the publication dates for network tariffs do not align with the requirements for retailers to publish standing offer prices. The most obvious way to make alignment would be for the AER to mandate an earlier publication date for network tariffs. Given the unlikelihood of this, the next best option is to introduce a requirement for the ESC to gazette the prices for all retailers or to reduce the four-week gazettal period to one week.

This is particularly relevant as from 1 July 2019 new requirements in the Energy Retail Code **('ERC')** require retailers to provide all customers personalised price change notifications, including an assessment of the best offer, at least five business days prior to the new rates applying. In the circumstance of publishing the VDO, and given the nature of the VDO's price determination not being a price change that needs an opportunity for the customer to seek alternate market offers, this seems a reasonable course of action.[3]

**4. What would be the implications of the alternative option – the VDO continuing to be a flat tariff (or flat tariff with controlled load tariff) only? Has the ESC properly considered the network tariff issues that arise from implementing the VDO?**

There is a risk that customers on non-flat tariffs making comparisons to the flat VDO will actually misrepresent the difference especially where demand tariffs are involved. Networks are continually developing and promoting non-flat network tariffs to price signals to the market. They are obliged to do this by the AER, subject to the AEMC determination. This was proposed by the COAG Energy Council.[4]

In response to the introduction of this rule change, the Minister decided to introduce a consumer protection into the AMI Tariffs Order. It provides choice to customers, allowing them to test whether they will be better or worse off under the price signal, and giving customers the ability to opt back onto flat network tariffs should the price signal be too difficult for the customer to manage.

**5. Does the approach and methodology specified in Clause 11 of the draft 13 Order appropriately reflect the objective of the VDO?**

Noting our view that the objective of the Order is flawed and should be revised to refer to the competitive market, we do not support the instruction for the Commission to ignore the expected costs and benefits of its determinations (sections 33(4)(a) and (4)(b) of the ESC Act). We view this as an important discipline that

[3] The original intention of the four week gazettal notice period we understand was to give customers on Standing Offers enough time to go to the market to search for a more competitive market price before the new Standing Offer prices came into effect.

[4] National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014, AEMC 27 November 2014.

forces the Commission to consider all aspects of the impact on customers (as well as the broader impacts) from its decisions. It is also a central tenet of good regulatory practice. The Department may want to compare the draft order with the Water Industry Regulatory Order 2014, which provides more detailed instructions to the Commission about what it should consider when it sets regulated prices for Victorian water businesses.

This would provide all stakeholders with some comfort that the Commission will make a decision that generates a net benefit for Victorian consumers. As many stakeholders have explained, some of the expected consequences of the VDO are reduced innovation and the withdrawal of the most competitively priced market offers (which imposes costs on the most price sensitive consumers). It is important that the Commission explicitly take account of these impacts when it makes determinations.

Other drafting in this clause provides little guidance to either the Commission or retailers about how it should make judgements on allowable acquisition and retention costs, and retailer margin. For example, it includes numerous subjective terms, such as 'not excessive', 'not unnecessarily or reasonably engaged in', and 'reasonable in all circumstances'. This creates considerable uncertainty about whether retailers can recover investments to improve service standards, for example, the benefits of which may not flow through to customers in the first year.

As we note below in our response to question 8, our preference is for the objective to account for the competitive market (and as a consequence, incentives for innovation) and for Clause 11 to instruct the Commission to consider specific factors when determining allowable acquisition and retention costs, and margin. The AEC also considers the ESC cost stack should make proper allowances for innovation given the reduced definition of 'headroom' to mean profit only.

**6. Will this approach assist customers to access the VDO? Or would it be preferable to prescribe the wording on bills and if so, what should this wording be?**

The timing and availability of bill space will preclude retailers from being able to accommodate specific wording on a bill for the VDO. To ensure consumers will still receive adequate notice and information about the VDO, the AEC suggests amendments to Clause 7(2) to just require retailers to communicate this to their customers. This may mean changing the obligation by removing the requirement to have the information 'on' the electricity bill. Additionally, requirements regarding what must be on a customer's bill are prescribed in the ERC (clause 25). If the Government must place this obligation on retailers, it is better placed in the ERC rather than the section 13 Order.

The AEC is also concerned that Clause 7(1) can be interpreted as obligating retailers to offer the VDO to all customers. The term 'prescribed customers' is a broad category that does not have the conditional effect of limiting the VDO.

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**7. Will the approach proposed in clauses 14 and 15 adequately meet the Government's intention to enable discounted offers to be easily compared?**

In addition to the matters raised above regarding the potential unintended consequences of implementing the VDO as a reference price, the AEC is concerned that the definition of 'other benefit' in clause 14(2) is unintentionally broad. It may capture offers such as cash sign-on incentives, magazine subscriptions or frequent flyer points. 'Other benefits' is very broad category and presumably includes non-price benefits. The purpose of a reference price is to ensure customers have a means of understanding and comparing discount offers on the price or tariff. However, if a customer is offered a magazine subscription or program points, the benefit is clearly the subscription or the points. Our view is that extending the obligation to 'other benefits' should not be included.

We are also unsure as to whether Clause 14(c) will provide duplicative obligations on retailers who are obliged to meet the clear advice entitlement from 1 July.[5] Some clarity as to its purpose in this regard, or if there is any other intended purpose, would be beneficial. One matter that must be considered is how the VDO will be used as a reference price, if retailers are able to offer standing offer prices at rates that are lower than the VDO. Will this require retailers to advertise two discounts? There are many unanswered questions, which have been raised by our members, in relation to the VDO as a reference price. We caution that the rushed implementation will create unintended consequences, which will add further confusion not clarity for consumers wishing to compare offers.

**8. Are there any other matters the ESC should be required to consider in setting prices for the VDO?**

The AEC believes that cost of innovation needs to be included. Innovation has never come for free, but it has provided benefits that exceed the costs. To innovate businesses allocate time, money and resources to develop new products and services, and to streamline operations. Innovation can lead and has led to cost savings, and by disallowing any space for these costs, the VDO approach locks innovation out. This is unlikely to be in the long term interests of consumers.

**Next steps**

The AEC requests that the Expert Panel release their Terms of Reference, and that the ESC's final advice is made public on the 3 May 2019.

For any questions about our submission please contact me either by email at david.markham@energycouncil.com.au or on (03) 9205 3107.

Yours sincerely,

David Markham
**Corporate Affairs**

[5] Explicit Informed Consent is a defined term in the Energy Retail Code. It requires that a Retailer fully and adequately disclosed in plain English all matters relevant to the consent of the customer.

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**Attachments**

- KPMG Evaluation of ESC Draft Advice on the Victorian Default offer, 16 April 2019
- Emerson Economics, Economic consequences of the Victorian Default Offer, 16 April 2019

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