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4 April 2019

Dr Ron Ben-David
Commissioner and Chair
Essential Services Commission

Sent electronically: retailenergyreview@esc.vic.gov.au

Dear Dr ~~Ben-David~~ *Ron*

Re: Submission to Victorian Default Offer to apply from 1 July 2019 – draft advice

Thank you for the opportunity to provide comments on the Essential Services Commission of Victoria's (ESC) draft advice on the Victorian Default Offer (VDO).

The ACCC has an interest in the implementation of the VDO as part of our ongoing monitoring of retail prices in our Electricity Market Monitoring inquiry. On 20 August 2018, the then-Treasurer, the Hon. Scott Morrison MP, directed the ACCC to hold a public inquiry to monitor the prices, profits and margins in the supply of electricity in the National Electricity Market (NEM). The ACCC must provide reports to the Treasurer at least every six months until 2025. The current inquiry follows the ACCC's *Retail Electricity Pricing Inquiry* (REPI) June 2018 report into the supply of retail electricity and the competitiveness of retail electricity prices in the NEM, which contained 56 recommendations. As part of our current inquiry, we are required to monitor the effects of policy changes in the NEM, which includes the work of the ESC in setting the VDO.

In our final REPI report, the ACCC identified that standing offers in non-price regulated jurisdictions of the NEM were often the highest priced offers in the market, and were not operating effectively as default offers or delivering essential consumer protections that would justify these high prices. To address these concerns, recommendations 30 and 49 of the REPI called for existing standing offers to be abolished and replaced with the Default Market Offer (DMO), which would provide similar consumer protections as standing offers, and for which the AER would set a maximum price.

The Australian Government has released for consultation a draft mandatory code under Part IVB of the *Competition and Consumer Act 2010* (Cth) (CCA) to implement the DMO, which the ACCC strongly welcomes. The AER will be responsible for determining the DMO price that will apply under the draft code for residential and small business customers in New South Wales, South Australia and south-east Queensland. The ACCC will be responsible for enforcing the provisions. The DMO will not apply in Victoria, given the Victorian Government's legislation to empower the ESC to determine the VDO price for each distribution region of Victoria.

As the ESC identified in its draft advice, the differences between the VDO and DMO largely stem from the different policy objectives driving the reforms. The stated purpose of the VDO

is to provide customers with universal access to a 'fair' price. In comparison, the DMO is described as a 'fall back position' and is intended to act as a cap for the price of default offers to limit the 'loyalty tax' that is levied on disengaged consumers. The key policy objective of the DMO price is to mitigate the impact of unjustifiably high prices for standing offer customers while allowing scope for continued competition in market offers.

The ACCC considers that the AER has struck an appropriate balance in setting DMO prices to address the 'loyalty tax' while also minimising the risk of competition being stifled. In recommending a default offer in the REPI, we envisaged that it should only be used by a small number of consumers. The ACCC considers that effective competition between retailers is the best vehicle for tackling inefficiencies in the supply of electricity to drive prices down further.

The ACCC acknowledges that the ESC is required to determine the VDO in line with the terms of reference that have been issued to it, which state that the ESC is to develop a 'fair' price for electricity. In its draft advice, the ESC has calculated the VDO at approximately the median market offer in each of the Victorian distribution zones. The ACCC has not identified problems with the methodology the ESC has proposed to calculate a 'fair' price in line with its terms of reference. However, we have concerns about the implications for competition and the long-term interests of consumers, specifically:

1. Individual customers that were shopping around and benefiting from retail competition may disengage and end up paying a higher amount under a VDO. The ACCC's concept of a default offer did not envisage that it would be an offer that retailers must make available; rather it would operate as a cap on standing offer prices. If consumers are encouraged to ask their retailer to be placed onto the VDO, this risks consumers missing out on better offers that are available in the market.
2. Competition could be dampened if there is a smaller pool of engaged customers for retailers to compete for. Engaged consumers drive efficiency in the electricity sector by responding to new offerings from retailers. Losing this engagement would result in less effective retail competition and the large number of current customers who are beneficiaries of competition could therefore be worse off.
3. Non-price competition and innovation could also be affected, to the long-term detriment of consumers. The retail electricity market is undergoing substantial changes, providing many opportunities for new and improved products and services to be delivered to consumers. With fewer engaged customers, some retailers, especially those that have unconventional or innovative retail offerings (e.g. wholesale exposed pricing, pay in advance, bundles) may find the Victorian market less desirable to enter. A lack of customer engagement may also reduce retailers' incentives to take up the opportunities to innovate presented by network tariff reforms. These reforms provide retailers (and by extension customers) with clear signals of the cost associated with their use of networks, which should drive consumer demand for home solar, battery storage and other new innovative energy services, as well as reduce network congestion and incentivise appropriate investment in infrastructure.

In addition, a key reform associated with the DMO is its use as a common reference bill against which all offers must be compared, following recommendations 32 and 50 of the ACCC's REPI final report. By forcing retailers to calculate advertised discounts from the DMO, consumers who shop around for their electricity deal will be better able to compare offers. The ACCC acknowledges that in its final response to the 2017 *Independent Review of the Electricity & Gas Retail Markets in Victoria*, the Victorian Government committed to address the marketing of offers using unanchored discounts. The ACCC also acknowledges that the ESC has previously stated in its December 2018 staff working paper that the price a retailer can charge under the VDO arrangements will be the basis from which retail

discounts will be measured. However, we note that in the ESC's draft advice no mention outside of the terms of reference is made to using the VDO in this manner.

The ACCC strongly encourages that the VDO be used as a reference price to base discounts off in the same manner as the DMO. As outlined in the REPI, many consumers make electricity purchasing decisions based on headline marketing claims, without taking further steps to determine how much they are likely to pay under the offer or whether they are able to meet the terms and conditions of the offer. While setting a VDO price will bring down the levels of standing offers, without requiring a common reference against which discounts must be compared, there is still scope for market offers to be advertised with high discounts off arbitrary bases.

The ACCC is willing to discuss any of these matters further. If you have any questions in relation to this submission, please contact Lyn Camilleri, General Manager, Electricity Markets Branch, on (03) 9290 1973.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Rod Sims', written in a cursive style.

Rod Sims
Chair

