

# A fair energy market for people on low incomes

Submission to the Interim Response to the Review of Electricity and Gas Retail Markets

April 2018



## About VCOSS

The Victorian Council of Social Service (VCOSS) is the peak body of the social and community sector in Victoria. VCOSS members reflect the diversity of the sector and include large charities, peak organisations, small community services, advocacy groups, and individuals interested in social policy. In addition to supporting the sector, VCOSS represents the interests of disadvantaged Victorians and advocates for the development of a sustainable, fair and equitable society.

This submission was prepared for VCOSS by Emma O'Neill in consultation with VCOSS member organisations.

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VCOSS acknowledges the traditional owners of country and pays its respects to Elders past and present.

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# Executive Summary

Unaffordable energy severely affects people on low incomes. In order to pay energy bills, people are restricting energy use to the detriment of health and wellbeing, and making trade-offs in relation to food and children's education expenses. People are paying higher energy prices than necessary, and are frustrated it is so difficult to navigate the market and find a more affordable deal.<sup>1</sup> The story of 'Tess' in VCOSS' *Power Struggles* report sums up some of these experiences.

## Tess's story

Tess is a sole parent to a primary school-age son. She is studying part-time and receives the Disability Support Pension. Tess rents her home through a co-operative housing provider. Tess is at home most days in a draughty, uninsulated home that is very expensive to heat and cool.

Tess wants to avoid a poor credit rating, so tries to pay her utility bills on time. She uses fortnightly deductions through Centrepay to set money aside for energy bills, but at the end of each billing period she still owes around \$150 each for gas and electricity bills. She is frustrated that due to her financial constraints she only receives the pay-on-time discounts for about one in five of her bills. Tess would like to find better energy deals and tried a comparison site but 'just found it all so complicated with kilowatts and I just don't know. I just like to hear it word of mouth'.

Every few months Tess gets food vouchers from a charity 'so I could sacrifice the food money to pay the bills... when I get an electricity or gas bill it just stumps me, and then rent on top of it.'

Delivering more affordable energy requires a fair energy market with reasonable and transparent pricing, as well as proper payment support for low-income households, and energy-efficient, affordable-to-run housing.

VCOSS strongly supports the majority of recommendations by the Independent Review of the Electricity and Gas Retail Markets in Victoria ('the Review'), which will help create a fairer market and pricing. We are pleased government has accepted recommendations 3 to 11 and is consulting further on recommendations 1 and 2 for the introduction of a 'Basic Service Offer' and the abolition of standing offers.

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<sup>1</sup> Victorian Council of Social Service, *Power Struggles: Everyday Battles to Stay Connected*, 2017.



The retail energy market is currently failing people on low incomes and other vulnerable groups, which necessitates both market reform and government support to make energy more affordable. In responding to the Review and the government's interim response and consultation paper, we have been cognisant of the following.

- The Review has highlighted the complexity and unfairness of the Victorian energy market. It is very difficult to compare energy deals, and common industry practices such as pay-on-time discounts mislead people into accepting relatively poor-value deals.
- Victoria has the highest retail costs in the nation, the reasons for which are unclear. The Review's findings on retail costs have been backed by the ACCC's preliminary report on retail electricity pricing.
- Deregulation has added costs to energy supply, and it is unclear whether a competitive market is producing lower net prices for customers than a market without competition.
- There is a lack of price transparency in the Victorian energy market. Without price transparency there will not be effective competition and prices will be higher than necessary.
- Some people face severe or intractable barriers to engagement, including major personal stresses such as poor health, inadequate income and financial crisis, family violence, and significant caring responsibilities. Sometimes the cheapest energy deals are inaccessible because of on-time or online payment conditions. Where people cannot engage with the market or are excluded from the best deals, they need to be assisted to access an affordable energy deal and be protected by proper government payment support.
- Government policies can increase energy costs for low-income households if they drive up retailer costs or cause a reallocation of costs from one set of customers to another. Government should analyse the distributional impact of any form of price regulation, and seek to avoid additional costs for low-income households.

In this submission we comment on issues raised by the proposed Basic Service Offer and request further analysis and consultation before government proceeds with this form of price regulation. We also recommend particular initiatives for low-income households, including a targeted, low-cost offer, and briefly comment on the implementation of recommendations for fairer energy contracts.

# Recommendations

## Understand the effects of price regulation

- Provide a detailed description of the proposed Basic Service Offer ('BSO') and the consequences of its introduction, particularly its impact on low-income households, including:
  - where the BSO is likely to sit in the market relative to other offers
  - the estimated distributional impact of the BSO
  - whether the components of the BSO are suitable
  - the effect of any anticipated changes to market structure caused by the BSO.

## Initiatives for low-income households

- Consult with community organisations and retailers about the optimal way of delivering a targeted offer to low-income households, including:
  - an offer with a maximum regulated price provided by all retailers
  - collective purchase on behalf of low-income customers by an intermediary
  - a government tender for a single retailer to supply a low-cost offer.
- Continue with the independent brokerage service pilot.
- Support low-income and vulnerable households to reduce their energy consumption by:
  - funding a large-scale energy-efficiency upgrade of private and social housing
  - introducing minimum rental standards and improved modification rights for tenants.
- Increase the Utility Relief Grant and improve its administration.

## Fair energy contracts

- Proceed to implement Recommendation 4 of the Review to ensure contract periods, practices and variations are clear and fair.

# Understand the effects of price regulation

## Recommendation 1

Provide a detailed description of the proposed Basic Service Offer ('BSO') and the consequences of its introduction, particularly its impact on low-income households, including:

- where the BSO is likely to sit in the market relative to other offers
- the estimated distributional impact of the BSO
- whether the components of the BSO are suitable
- the effect of any anticipated changes to market structure caused by the BSO.

VCOSS would be supportive of price regulation that results in low-income households paying lower prices for energy. However, there is a lack of information and analysis on whether the form of price regulation proposed by the Review would have that effect.

The Review recommended the introduction of a 'Basic Service Offer' ('BSO'). All retailers would be required to offer a BSO either at or below a regulated maximum price. The BSO would be available to all energy customers, regardless of income or level of market engagement. The BSO is intended to be a 'no frills' offer, and to send a price signal about a reasonable price of energy for a 'basic' service, allowing customers to compare the BSO with other offers in the market.

The Essential Services Commission (ESC) would set the maximum regulated price of the BSO. We understand the BSO would be unconditional, meaning it would not require actions like paying on time or online billing to receive its benefits. In determining the maximum regulated price of the BSO, the ESC would:

- include the efficient costs to run a retail business
- allow for regulatory compliance costs
- allow for an appropriate retail profit margin
- exclude customer acquisition and retention costs (CARC) and headroom.

The BSO would represent a significant intervention in the Victorian energy market. Yet it is hard to tell what effect it will have, including how it affects market prices or customer outcomes, particularly for people on low incomes.

The Review provided only a brief description of the BSO's intent and how the BSO would be set, alongside aspirational statements about the BSO's role in the market. The Interim Response simply repeats these statements.

We had anticipated that the Victorian Government would have a clear prediction of how any BSO would affect the energy market, including its anticipated price level, coverage, and the resulting reduction in energy costs people would be likely to receive. Similarly, it remains unclear how the BSO might affect different types of people, including those on low incomes or concessions, or highly engaged customers versus those with little market engagement.

The Victorian Government should analyse:

- how high the regulated BSO price will be compared with market offers
- the estimated distributional impact of the BSO
- the most appropriate cost components of the regulated price
- the consequences of changes to the energy market structure caused by the BSO.

## Position of offer in the market

It is unclear where the BSO is likely to sit in the market in relation to other offers. The Review and the Interim Response envisage the BSO would operate as a 'reasonable', seemingly mid-level offer, with retailers theoretically free to offer other deals above or below the BSO's regulated price.

However, it is uncertain whether the BSO would operate in that way.

It could conceivably operate as a floor price, because the BSO does not allow for customer acquisition and retention costs (CARC) or headroom costs and would constrain retailers' margins. In this scenario, retailers could respond to the introduction of the BSO by withdrawing other low-cost offers, and concentrate on developing higher-cost products for that part of the market that could be convinced to purchase them.

Regardless of whether the BSO is a floor price or a mid-level price, people would be vulnerable to higher pricing above the BSO, particularly if they struggle to engage with the market. The BSO may not necessarily ameliorate problems stemming from high pressure sales techniques, 'tick-a-box' offers, such as when commencing a rental lease, confusing commercial comparison sites that may suggest higher-priced offers, or evergreen market offers, that keep people on uncompetitive prices.

Low-income customers would especially need to be made aware of the BSO and be encouraged to switch, and regulatory reforms may be required so that all customers default onto the BSO at the end of a benefit or contract period.



However, maximising access to the BSO may cause the BSO to become the predominant price in the market over time. As noted in the Review's commissioned analysis, by raising awareness of price regulation the Victorian government may inadvertently

*'cause some confusion about whether customers can still access competitive offers and there may potentially be unwarranted assumptions that the regulated price must be better than a competitive price'.*

And that a

*'regulated tariff may also be viewed as being more predictable and a "safer" choice than a tariff set by a business'.<sup>2</sup>*

These perceptions may widen uptake of the BSO. In this scenario, the only active part of the market may be where retailers can squeeze additional cost reductions through 'conditional' offers, such as electronic billing and on-time payment, which may be inaccessible to the most disadvantaged households, leaving them on the highest priced 'full-service offer'.

If this scenario eventuates, then a great deal hinges on the ability of the regulator to set a 'fair price' without reference to market prices, as there may be little market activity to draw from.

## **Distributional impact of offer**

It is difficult to assess the impact of the BSO if we cannot reliably determine the proportions of low-income households that may be either worse off or better off.

The Review's commissioned analysis concluded 'passive' customers tend to benefit from price regulation, while active customers who value choice may be worse off. Price dispersion is typically lower in markets with price controls, which benefits customers who cannot or do not shop around.<sup>3</sup>

We do not currently have information about which consumers tend to be 'passive' customers. If low-income and vulnerable customers are predominantly 'passive' customers, then successful price regulation may make them better off overall. This is especially the case if there are mechanisms to ensure these consumers will transition to the regulated price, and there are strong hardship and government supports for the minority who may face higher prices.

However, there is a lack of publically available information on how low-income and vulnerable customers are currently distributed across the range of offers in the market. Based on member feedback, some low-income and vulnerable customers will be on relatively high-priced deals because they face barriers to shopping around and pressuring their existing retailer for a better deal. Those barriers include digital exclusion, poor credit ratings and payment histories, literacy or language barriers, health problems, family violence, and other personal stresses that make searching for an energy deal impossible or a low priority.

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<sup>2</sup> KPMG, *Energy retail markets: An international review—A report for the Victorian Department of Environment, Land, Water and Planning*, April 2017, 45.

<sup>3</sup> Ibid.

We also recognise some low-income households will currently be enjoying the most competitive deals in the market, including customers who have accessed lower rates through their retailer's hardship program, customers who have been assisted by community organisations to find a good value deal, and price-seekers who are energy 'budget-shoppers' in a similar way to groceries and other goods and services.

Research conducted in 2016 showed 28 per cent of vulnerable, low-income households had switched energy provider or plan in the past 12 months, the second highest switching rate among the households surveyed. Secure, higher income households had a lower switching rate of 21 per cent.<sup>4</sup> This analysis suggests that while the majority of vulnerable, low-income households may face searching and switching barriers, a significant proportion of those households seem to be engaging with the market. However, we do not know whether customers are enjoying relatively good value deals as a result of switching.

## Composition of offer

Energy bills are made up of wholesale, network, environmental/policy and retail costs. The BSO is designed to constrain the retail component of the bill. VCOSS agrees with the Review's concerns about Victoria's high retail costs, which lead the nation at approximately 30 per cent of the total bill.<sup>5</sup> Compared with other jurisdictions in the National Electricity Market, retail margins are somewhat higher in Victoria, and retail charges have been a bigger driver of price increases in Victoria over the past decade.<sup>6</sup> It remains unclear why the retail component of the bill is higher in Victoria than elsewhere.

In any BSO proposal, the Victorian Government should identify exactly which costs make up the retail component beyond CARC and headroom, including costs to serve, regulatory compliance, debt and financing, etc.

We share the Review's concern that some retail costs, including CARC, may be excessive and do not appear to be constrained by competition. More fundamentally, it is unclear whether the 'costs of competition' such as CARC are producing a net benefit for people in the form of lower prices.

However, we note that each retailer's BSO will still require marketing by retailers, especially if government wants to maximise uptake, and it is unclear who bears these costs. As other jurisdictions have found, the mere availability of benefits for vulnerable customers is not sufficient to ensure those customers take up those benefits. Other mechanisms are needed to maximise access, such as obligations on retailers to provide information to customers.<sup>7</sup>

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<sup>4</sup> Newgate Research, *Australian Energy Market Commission 2016 Retail Competition Review: Understanding vulnerable customer experiences and needs—Consumer research report*, June 2016, 21.

<sup>5</sup> *Independent Review into the Electricity & Gas Retail Markets in Victoria*, August 2017; Australian Competition and Consumer Commission, *Retail electricity pricing inquiry: Preliminary report*, 22 September 2017, 39.

<sup>6</sup> Australian Competition and Consumer Commission, *Retail electricity pricing inquiry: Preliminary report*, 22 September 2017, 39-40.

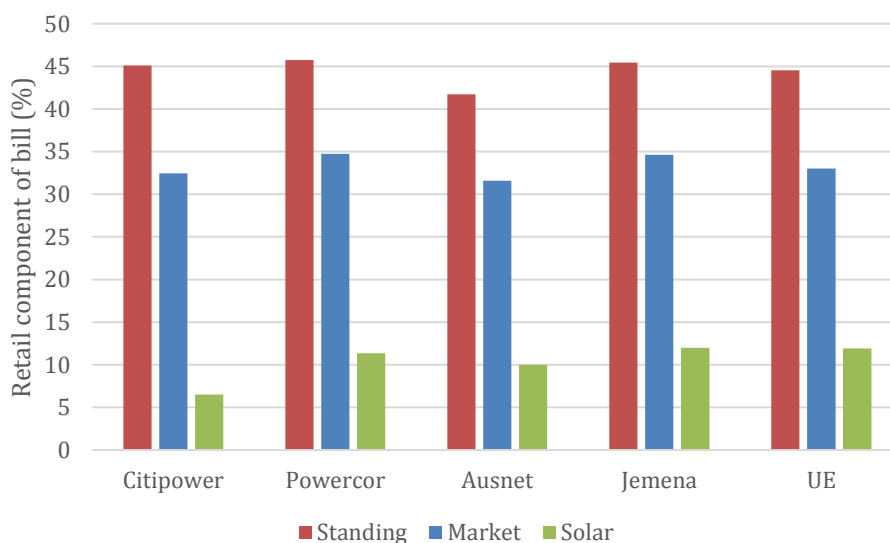
<sup>7</sup> KPMG, *Energy retail markets: An international review—A report for the Victorian Department of Environment, Land, Water and Planning*, April 2017, 28.

If introduced, the BSO should contain the full suite of customer protections and be accessible to low-income customers who may find it difficult to access some of the lowest price deals in the market. For example, it should allow for paper bills, Australia Post payments, access to Centrepay, high-quality call centre services, and access to hardship assistance. The maximum regulated price will therefore need to incorporate cost components for these measures, appropriately distributed among customers.

Another cost consideration is managing wholesale pricing risks. These costs appear to be attributed to the retail component of the bill. These costs may increase in the years to come if, as proposed, retailers are responsible for complying with the National Energy Guarantee (NEG), and the cost of administering wholesale financial instruments becomes more expensive.

We also observe the BSO does not seek to deal with the fact that the retail component of the bill is higher for non-solar households than solar households, as shown in Table 1 below.

**Table 1: Estimated retail proportion (%) of bills for standing offers, market offers (including pay on time discounts) and solar market offers (including pay on time discounts), average annual bill based on the offers taking effect post January 2018 (3 kW system, 4,800kWh per annum, single rate, excluding GST)**



Source: St Vincent de Paul Society and Alviss Consulting, Victorian Energy Prices January 2018

## Effect of changes to market structure

The Review acknowledged price regulation may reduce the number of energy retailers, but stated the ‘counter point is that the expansion of market competitors in Victoria has not reduced energy retail prices’.<sup>8</sup> We are unclear whether prices would have been higher or lower in Victoria if there were fewer retailers.

The BSO could increase market concentration if it advantages large retailers over smaller ones. It appears CARC are higher for smaller retailers,<sup>9</sup> so their removal may more severely reduce the margins of smaller retailers. We would also expect larger retailers could more easily manage compressed margins with higher sales volumes.

The Review stated the BSO explicitly provides an option for people to ‘remain protected from the existing failures of the market’. In other words, it seeks to provide an option for consumers to no longer participate in the market. This is necessarily an advantage to their incumbent retailer, as it effectively discourages them from switching to a new retailer.

The Review suggests that to achieve lower prices, it is acceptable to have increased market concentration and reduced competition. However, we have insufficient evidence that lower prices will eventuate. If they do not, then consumers may be worse off than before.

## Role of the regulator

Under any form of price regulation, the ESC will need to be able to compel detailed pricing information from retailers, and have strong capacity to assess retail pricing strategies and input costs such as wholesale and network costs.

Given some of the potential scenarios discussed above, the regulator needs to be able to make certain price determinations while resisting potential ‘gaming’ or regulatory capture. VCOSS is aware that energy pricing is complex, and can require detailed expertise to analyse, much of which currently resides within energy retailers themselves. Particularly in a more concentrated market, regulatory processes need to be able to engage beyond retailers themselves, and examine production costs in detail. The more competition is weakened, the less the regulator can refer to ‘market prices’, especially if they are amenable to gaming by retailers. For example, vertically integrated businesses can manipulate internal transfer pricing, such as wholesale costs, which can artificially inflate the prices of components of the bill.

Consumer groups will need to be resourced to participate in price regulation processes, and clear parameters will need to be set around which matters are appropriate for consumer engagement, and which matters are primarily the responsibility of the ESC to analyse. Consumer groups are at an inherent disadvantage in price regulation processes, and have a more limited ability to

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<sup>8</sup> *Independent Review into the Electricity & Gas Retail Markets in Victoria*, August 2017, 55.

<sup>9</sup> *Ibid* 25-26.

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understand technical pricing issues and identify what constitutes 'efficient' pricing, or obtain expert opinion on those matters.



# Initiatives for low-income households

VCOSS' primary goal is to ensure low-income and other vulnerable households can afford adequate energy. Within the context of the Review, major priorities are:

- access to a low-cost energy offer and an energy broker
- proper payment support, and
- energy-efficiency upgrades to reduce consumption.

## Targeted offer for low-income households

### Recommendation 2

Consult with community organisations and retailers about the optimal way of delivering a targeted offer to low-income households, including:

- an offer with a maximum regulated price provided by all retailers
- collective purchase on behalf of low-income customers by an intermediary
- a government tender for a single retailer to supply a low-cost offer.

A targeted offer is important for low-income households because they may be excluded from the most competitive deals in the market. Pay-on-time and direct debit deals may not be feasible if people have unpredictable incomes, insufficient incomes, or frequent disruptions to household budgets. Lower-priced, online-only deals are inaccessible to people without internet access. VCOSS members report people with poor credit records or histories of debt and disconnection can find it difficult to secure deals with lower-priced retailers.

VCOSS therefore recommended to the Review panel that government introduce a simple, low-cost offer with a reasonable tariff targeted at low-income households. This offer should at least be available to customers on retailers' hardship programs, and would ideally be available to concession card holders as well. Like the BSO, government would need to consider the distributional impact of a targeted offer and ensure it was appropriately restricted so as not to add unreasonable costs to other customers.

A targeted offer could be delivered in one of several ways:

- an offer with a regulated maximum price that would have to be provided by all retailers, with restrictions on the types or level of costs that can be charged, similar to the BSO
- collective purchase on behalf of low-income customers by an intermediary, whether from multiple retailers or a single retailer

- a government tender for a single retailer to supply a low-cost offer.

A targeted offer for low-income households should, as far as possible:

- deliver a low energy price while providing the full suite of consumer protections and flexible payment methods
- be easy to access
- require minimal market engagement.

A tender for a single retailer to supply a targeted offer may result in the lowest-priced offer of the three models, as it contains economies of scale by awarding a single retailer with a significant market share. It may also require the least engagement of the three models because it does not require use of a collective purchasing intermediary, or involve offers by multiple retailers.

Government should consult with community organisations and retailers about the optimal way of delivering a targeted offer to low-income households, including the three models discussed above.

## Energy broker

### **Recommendation 3**

Continue with the independent brokerage service pilot.

We are pleased to see government commence a pilot of an independent brokerage service for low-income and other vulnerable customers, consistent with recommendation 7A.

VCOSS continues to recommend the pilot extend market-wide, in order to increase price transparency and drive competition across the market. We have requested the ACCC consider whether automated switching services could be provided as part of a brokerage service, on the proviso the brokerage is an independent, government-based service. A market-wide brokerage and switching service in Victoria could be integrated with the proposed Energy Data Hub, which will provide personal energy data for consumers to share with authorised third parties.

## Support to reduce energy consumption

### Recommendation 4

Support low-income and vulnerable households to reduce their energy consumption by:

- funding a large-scale energy-efficiency upgrade of private and social housing
- introducing minimum rental standards and more flexible modification rights for tenants.

We welcome government's acceptance of recommendation 6B, to support programs that help low-income and vulnerable households reduce their energy consumption. Government can build on the 'Home Energy Assist' program by funding a large-scale energy-efficiency upgrade of private and social housing. The program could comprise a mix of government-funded upgrades, subsidised upgrades, and No Interest Loan Scheme financing.

The program should be supported by improved modification rights for tenants that allow them to make non-structural modifications without landlord consent. VCOS members report the requirement for landlord consent to even minor energy-efficiency upgrades is a major barrier to tenants receiving the benefits of subsidised improvements that reduce energy consumption.

Minimum rental standards, including minimum energy efficiency standards, would also make a major difference to the energy consumption of private renters in Victoria. Basic energy-efficiency measures like insulation and efficient appliances have as much potential to reduce energy bills as retail pricing reforms.<sup>10</sup>

## Payment support—Utility Relief Grant

### Recommendation 5

Increase the Utility Relief Grant and improve its administration.

The Victorian government should prioritise recommendation 6D to review the administration of the Utility Relief Grant (URG) scheme so it is serving customers most in need. The current URG administration is in urgent need of reform to make the application process easier for people in financial crisis, potentially by allowing retailers to complete the application on behalf of customers with their consent.

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<sup>10</sup> See Sustainability Victoria, *Victorian households energy report*, May 2014; South East Councils Climate Change Alliance, *Energy saver study: low income energy saver direct care and motivators project—Final report executive summary*, May 2016.

The monetary cap on the URG also needs to be immediately increased from \$500 to \$750 to take account of current average energy costs over a six-month period.<sup>11</sup>

VCOSS is very concerned government has commenced a review of the URG scheme and aims to complete the review by mid-2018, despite not having consulted VCOSS and its members to date.

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<sup>11</sup> Based on *Independent Review into the Electricity & Gas Retail Markets in Victoria*, August 2017, 11.

# Fair energy contracts

## Recommendation 6

Proceed to implement Recommendation 4 of the Review to ensure contract periods, practices and variations are clear and fair.

VCOSS welcomes government's support for recommendations 4A to 4E, which will:

- require retailers to fix any prices they are offering for a minimum of 12 months
- require retailers to clearly disclose the length of time any offered prices will be available without change
- require retailers to roll customers onto the nearest-matching, generally available offer at the end of a contract or benefit period, unless the customer opts for another offer
- require any conditional discount or other benefit for paying on-time or online billing to be evergreen and continue when the contract ends
- cap costs incurred by customers for failing to meet offer conditions, which are not to be higher than the reasonable cost to the retailer.

## Evergreen discounts for on-time payments and online billing

VCOSS would prefer deep discounts for on-time payments and online billing to become less common in the Victorian energy market, and for competition on actual pricing to take their place. These types of conditional discounts discriminate against people who lack the capacity to pay on time or online, and can provide a misleading sense of value, as it is rarely clear what the discount is off. The actual indicative price for energy under a discount deal is rarely displayed.

We support evergreen discounts but note they could have several effects on the market. First, they may reduce the level of discounts offered by retailers. Some discounts may not be sustainable for retailers on a long-term basis, and retailers may have less of an incentive to attract new customers with large discounts if customer stickiness increases due to evergreen discounts. However, a reduced discount does not necessarily mean a poor-value offer. As the Review and the ACCC have found, smaller discounts may represent a greater saving than large discounts, depending on the underlying price from which the discount is taken.<sup>12</sup> Information about actual pricing will

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<sup>12</sup> Ibid 31; Australian Competition and Consumer Commission, *Retail electricity pricing inquiry: Preliminary report*, 22 September 2017, 127-130.



therefore be important to help people assess value, including the requirement for retailers to market offers in dollar terms and actual annual costs where these are able to be estimated (recommendations 3A to 3D).

Second, there is a risk of customers remaining stuck on expensive deals in the belief a large, evergreen discount represents good value. It will therefore be important for people to be notified of the retailer's best offer on bills under recommendation 3G.

### **Cap on costs for failure to meet offer conditions**

People can face 'penalties' of hundreds of dollars per year for not meeting offer conditions like on-time payment, which has a severe effect on low-income households. The cap on costs for failure to meet offer conditions should therefore be implemented as soon as possible. Government could take guidance from other industries, such as water businesses, about the reasonable business costs of late payment and paper billing, and any practices of waiving late payment or paper billing fees for low-income customers.

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