

# Retail electricity supply and pricing

Submission to the Australian Competition and Consumer  
Commission inquiry

July 2017



## 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 vulnerable and disadvantaged Victorians in policy debates and advocates for the development of a sustainable, fair and equitable society.

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

# Contents

Glossary .....	2
High electricity prices harm people on low incomes .....	3
Recommendations .....	5
Causes of price increases .....	6
Wholesale costs .....	7
Network costs .....	8
Environmental scheme and other policy costs.....	9
Retail costs .....	10
Lack of pricing and cost transparency .....	13
Confusing, unclear pricing.....	14
Pricing representations in Victoria .....	14
Ambiguous ‘benefit periods’ and subsequent pricing.....	18
Unclear and potentially uncompetitive fixed charges .....	19
Consumer education has its limits.....	21
Independent energy broker .....	22

# Glossary

This glossary has been prepared for readers who are not familiar with some of the terms used in the energy market.

<b>Consumption charge</b>	The amount paid for each unit of electricity or gas used. Otherwise known as the 'variable charge' or the 'usage charge'.
<b>Discount offer</b>	An energy offer that includes a discount. In Victoria, the discount is usually conditional on certain types of behavior, such as paying the bill on time, or paying by direct debit or online. Few retailers offer non-conditional discounts.
<b>Fixed charge</b>	The amount paid for the fixed costs of supplying energy, such as network costs. The fixed charge is the same regardless of how much energy you use. Fixed charges are often described as only covering network costs, but in Victoria they can include retail costs. Otherwise known as the 'daily supply charge' or the 'service to property' charge.
<b>Market offer</b>	The main type of energy offer in Victoria. Market offers are set by retailers and can change during the contract period.
<b>Standing offer</b>	The 'default' energy offer provided to people who do not sign-up to market offers. Each Victorian retailer sets its own standing offer. They are not regulated by the Victorian government. Standing offers are generally more expensive than market offers.

# High electricity prices harm people on low incomes

The Victorian Council of Social Service (VCOSS) welcomes the opportunity to contribute to the ACCC's inquiry into retail electricity supply and pricing. VCOSS has long advocated for affordable energy supply for people on low incomes, including people whose health and wellbeing can be compromised without adequate energy use, such as:

- families with children
- older people
- people reliant on poor-quality, energy inefficient rental housing
- people with medical cooling needs
- people with disability who need affordable, reliable energy supply to charge mobility and communication aids and perform other essential tasks.

VCOSS represents over 300 community sector members, including large charities, peak organisations, small community services, and advocacy groups, who provide a wide range of support to people experiencing poverty and disadvantage.

VCOSS members tell us people are being pushed to the edge by electricity price rises. Victorian electricity prices are now the second highest in Australia, following South Australia.<sup>1</sup> Between 2006 and 2016, Victorian electricity prices increased by 119 per cent, or an average of 12 per cent a year,<sup>2</sup> far in excess of general inflation. Price increases have vastly outpaced record low wages growth and inadequate income support payments.<sup>3</sup> This occurs in a context where constrained incomes are being further depleted by very high housing costs.<sup>4</sup>

Faced with these pressures, people find it increasingly difficult to make bill payments. A forthcoming VCOSS report shows people are making trade-offs on food and other essentials, and sometimes experiencing great psychological stress, in order to stay connected to energy supply.<sup>5</sup>

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<sup>1</sup> St Vincent de Paul Society and Alviss Consulting, *The NEM: A hazy retail maze—Observations from Vinnies' tariff-tracking project*, December 2016, 9; Australian Energy Regulator, *State of the Energy Market: May 2017*, 2017, 129.

<sup>2</sup> Ben Phillips, *Research note: Household energy costs in Australia 2006 to 2016*, ANU Centre for Social Research and Methods, February 2017.

<sup>3</sup> South Australian Council of Social Service, *SACOSS Cost of Living Update: No. 30, March Quarter 2017*, 2017; Australian Bureau of Statistics, *Wage Price Index, March Quarter 2017*, cat. no. 6345.0.

<sup>4</sup> Councils of Social Service, *Payment adequacy: A view from those relying on social security payments*, 2015, 10; The Salvation Army, *Economic and Social Impact Survey 2017: The Hard Road*, 2017, 23.

<sup>5</sup> To be published in July 2017.

Recent research by the New South Wales Council of Social Service shows people are making similar sacrifices in that state.<sup>6</sup>

Electricity bills are one of the most common reasons for seeking emergency relief.<sup>7</sup> Victoria has high disconnection rates relative to other jurisdictions.<sup>8</sup> After declining during the 2015-16 financial year, disconnections have started to increase.<sup>9</sup>

VCOSS considers electricity can be made more affordable for people on low incomes through retail electricity market reforms. Separately to the ACCC inquiry, VCOSS made a submission to the Victorian Retail Energy Markets Review. While there are similar recommendations in each submission, we acknowledge the ACCC inquiry has greater capacity to investigate electricity price changes through use of its compulsory information-gathering powers.

Victoria was the first jurisdiction to fully deregulate electricity retailing. Based on the available data, the causes of Victorian retail price increases are somewhat different to other states and territories. In particular, Victorian electricity bills have higher retail cost components than other jurisdictions, and network costs appear to have played less of a role in price increases over the past decade. We therefore ask the ACCC to enquire into jurisdictional differences as far as possible.

We also seek analysis of how price rises and the cost components of retail prices particularly affect low income households, including environmental scheme costs associated with RETs and solar feed-in tariffs, and other government policy costs.

VCOSS considers electricity can be made more affordable through:

- more extensive, consistent data collection requirements in relation to the cost components of retail electricity pricing and the causes of price changes, which can inform policy development to put downward pressure on prices
- transparent electricity pricing—current pricing is confusing and hinders competition. The use of comparison rates for electricity pricing could help people better compare electricity offers and improve competition
- potential regulatory action in relation to the use of ambiguous, confusing ‘benefit periods’, which can result in people lapsing onto relatively expensive electricity deals
- reform of fixed charges, to encourage competition around total retail costs—currently, some retail costs are hidden in the fixed charge and are arguably shielded from competition
- introducing an independent energy broker to help people find a more affordable energy deal.

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<sup>6</sup> New South Wales Council of Social Service, *Turning off the lights: The cost of living in NSW*, June 2017.

<sup>7</sup> Benno Engels, Rivkah Nissim and Kathy Landvogt, ‘Financial Hardship and Emergency Relief in Victoria’ (2012) 65(1) *Australian Social Work* 54; Patrick Rehill, *Examining Changes in Emergency Relief Provision: An Analysis of 2011-14 Emergency Relief Data*, St Vincent de Paul Society, 17.

<sup>8</sup> Essential Services Commission, *Victorian Energy Market Report 2015-16*, November 2016, 38.

<sup>9</sup> Essential Services Commission, *Victorian energy market update 2016-17*, Issue 2—January to March 2017, 30 June 2017, 3.

# Recommendations

## Causes of price increases

- Analyse wholesale cost drivers, including the effects of the transition to lower-emission generation sources, and the impact of wholesale costs on retail prices.
- Analyse the impact of environmental scheme and other government policy costs on low income households, and any likely changes to environmental scheme costs arising from the transition to a lower-emissions electricity market, including any increase in solar feed-in tariff costs as more households install distributed energy arrangements.
- Examine the reasons for Victoria's high retail costs, and whether low income households are disproportionately funding those costs via standing and non-discount market offers.
- Establish data collection requirements in relation to the cost components of retail electricity pricing, the causes of price changes, and customer outcomes in retail electricity markets on an ongoing basis.

## Confusing, unclear pricing

- Consider how electricity price representations can be made more transparent and comparable, including through a comparison rate model.
- Investigate whether benefit periods may constitute misleading or deceptive conduct, or an unfair contract term, under the *Competition and Consumer Act 2010* (Cth).
- Seek industry data on customer outcomes at the end of benefit periods.
- Consider whether there is a lack of transparency around the composition of fixed charges and whether the fixed charge should be based on network and policy costs only.

## Consumer education has its limits

- Examine the benefits of an independent energy brokerage service for residential customers.

# Causes of price increases

Adequate data on retail price movements and their causes is difficult to obtain. The existing data tends to track standing offers, which are generally higher than market offer prices, so price increases may have been lower than the existing data suggests. Nevertheless, even if market offers were factored in, it is likely electricity price rises substantially outpaced CPI over the past decade.

While we appreciate the ACCC will be obtaining industry data on the causes of price increases, we comment briefly on what seem to be the main causes. We also note that although the cost components of Victorian electricity prices are the same as other states and territories, the respective contributions of these costs differ from other states and territories. We therefore suggest the ACCC's analysis of retail prices needs to be conducted jurisdiction-by-jurisdiction, rather than at a national level.

The ACCC should also detail the cost components of retail electricity prices to determine if costs are shared equitably between different household types, including environmental scheme and other government policy costs. VCOSS supports policies aimed at emissions reduction, but we are concerned RET and solar feed-in tariff costs are currently being recovered in an inequitable way and produce higher bills than necessary for people on low incomes. The funding of these government policy measures is not proportionate to household income but the level of grid electricity used, particularly disadvantaging people on low incomes. Low-income households are generally less able than more affluent households to significantly reduce grid electricity use by installing solar systems and energy efficiency measures, whether due to housing tenure (living in private rental or social housing) or constrained incomes.<sup>10</sup> As well as being more reliant on grid electricity, people in financial difficulty can experience higher than average consumption levels.<sup>11</sup>

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<sup>10</sup> Queensland Productivity Commission, *Solar feed-in pricing in Queensland—Final report*, June 2016, 119-131; New South Wales Council of Social Service, *Turning off the lights: The cost of living in NSW*, June 2017, 20-22.

<sup>11</sup> Lauren Solomon, 'Effective support for vulnerable households—closing the gap between capacity to pay and cost of consumption, Part 2', AGL energy sustainability blog, <http://aglblog.com.au/2015/09/effective-support-for-vulnerable-households-closing-the-gap-between-capacity-to-pay-and-cost-of-consumption-part-2/>.



## Wholesale costs

### Recommendation

Analyse wholesale cost drivers, including the effects of the transition to lower-emission generation sources, and the impact of wholesale costs on retail prices.

Until recently, there does not appear to have been a relationship between wholesale price trends and retail price increases in Victoria. Although wholesale prices have been volatile over the past decade, the long-term trend has been fairly flat until recently, and there is no apparent trend in wholesale pricing that could explain the marked increase in retail prices from 2005.<sup>12</sup>

The drivers of wholesale costs are complex. One cause of the recent price spike appears to be the poorly managed transition to lower-emission generation sources, as well as rising wholesale gas prices (across the National Electricity Market (NEM), gas-fired electricity generation sets the marginal wholesale cost).<sup>13</sup> The Finkel review states:

Recently in the NEM, there has been relatively flat or decreasing demand, and additional VRE [variable renewable electricity] capacity has been incentivised to enter the market through the Renewable Energy Target scheme. This has resulted in a sustained period of relatively low wholesale prices, which gives little incentive for additional generation to enter the market. Uncertainty around emissions reduction policy has further inhibited new investment in dispatchable capacity.

Under these conditions, the [energy] market is expected to quickly shift from a state of capacity oversupply to undersupply, when generators exit the market with relatively little notice. This leaves the system operating in a state of undersupply, which rapidly increases prices and has adverse implications for reliability.<sup>14</sup>

The closure of the Hazelwood power station will likely put further pressure on wholesale costs in the short to medium term, which has already been reflected in significant Victorian standing offer price rises of between 6 to 10.5 per cent in January 2017.<sup>15</sup>

A further wholesale cost driver, according to the Finkel review, is increased wholesale spot price volatility due to increasing renewable electricity generation in the NEM. Because this type of generation can drop relatively suddenly, other sources of generation may have to rapidly ramp up. This increases price volatility, and potentially the cost of managing this price volatility through hedge contracts. In future, however, the Finkel review suggests that ‘the fact that VRE [variable

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<sup>12</sup> T Wood, D Blowers and G Moran, *Price shock: Is the retail electricity market failing consumers?*, Grattan Institute, 2017, 8. See also Australian Energy Regulator, *State of the Energy Market: May 2017*, 2017, 51-52.

<sup>13</sup> *Independent review into the future security of the National Electricity Market: Blueprint for the future*, Commonwealth of Australia, 2017, 78-81.

<sup>14</sup> *Ibid* 79-80.

<sup>15</sup> Australian Energy Regulator, *State of the Energy Market: May 2017*, 2017, 133.

renewable electricity] generators operate with no fuel cost could, with the right policy framework and further technological development, be used to reduce overall wholesale prices.<sup>16</sup>

While the current inquiry focuses on the retail electricity market, we seek ACCC analysis of wholesale cost drivers to the extent possible, given they are increasingly affecting retail prices.

## Network costs

Network charges are estimated to comprise 45 per cent of Victorian electricity bills, close to the national average of 46 per cent.<sup>17</sup> The network charge component of bills varies between standing offers and market offers in Victoria:

- for market offers taking effect post-July 2016, network charges comprised 36 to 47 per cent of the average annual bill
- by comparison, for standing offers taking effect post-July 2016, network charges comprised 29 to 37 per cent of the average annual bill, depending on network area.

This is largely because retail costs take up a larger component of Victorian standing offers, and a relatively smaller component of market offers.<sup>18</sup>

Network costs do not fully explain Victorian retail price increases. Retail prices have outpaced network costs over the past decade.<sup>19</sup> Network costs do not appear to be the main cause of the 2017 electricity price increases. If network costs were a major cause, we would expect to see some pattern in retail price increases within a network area. However, recent standing offer increases in January 2017 varied significantly among retailers within each network area.<sup>20</sup>

The AER states significantly lower network charges in Victoria helped offset the impact of rising wholesale costs in 2016, and in fact contributed to bill reductions.<sup>21</sup>

Victoria may therefore be in a relatively unique position in terms of network costs, compared with some other states and territories.

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<sup>16</sup> *Independent review into the future security of the National Electricity Market: Blueprint for the future*, Commonwealth of Australia, 2017, 79.

<sup>17</sup> Australian Energy Regulator, *State of the Energy Market: May 2017*, 2017, 129.

<sup>18</sup> St Vincent de Paul Society and Alvis Consulting, *The NEM: A hazy retail maze—Observations from Vinnies' tariff-tracking project*, December 2016, 18-20.

<sup>19</sup> T Wood, D Blowers and G Moran, *Price shock: Is the retail electricity market failing consumers?*, Grattan Institute, 2017, 9.

<sup>20</sup> St Vincent de Paul Society and Alvis Consulting, *Victorian Energy Prices, January 2017*, 2017, 15, 28-38.

<sup>21</sup> Australian Energy Regulator, *State of the Energy Market: May 2017*, 2017, 133.

## Environmental scheme and other policy costs

### Recommendation

Analyse the impact of environmental scheme and other government policy costs on low income households, and any likely changes to environmental scheme costs arising from the transition to a lower-emissions electricity market, including any increase in solar feed-in tariff costs as more households install distributed energy arrangements.

Environmental scheme and other government policy costs affect retail prices in most jurisdictions. This includes the costs of:

- meeting renewable energy targets (RETs)
- meeting energy efficiency targets, like the Victorian Energy Efficiency Target (VEET)
- making solar feed-in tariff payments to households with rooftop solar systems (in Victoria, solar feed-in tariffs are set by the Essential Services Commission)
- the fixed price on carbon (until its abolition in 2014).

Environmental scheme costs range from 6 per cent of an average electricity bill in Tasmania, to 14 per cent of an average electricity bill in Queensland. Environmental scheme costs account for 7 per cent of electricity bills in Victoria, the second lowest proportion in the NEM after Tasmania.<sup>22</sup>

Although environmental scheme costs represent a relatively low proportion of Victorian bills, they appear to have been a significant cause of Victorian retail price increases over the past decade. Oakley Greenwood has analysed contributions to change in Victorian electricity bill prices. Their analysis shows government policy costs accounted for the largest source of electricity bill increases between 2008 and 2016 (44.1 per cent of the increase) and 2008 and 2017 (37.4 per cent of the increase). Breaking this down, over the 2008 to 2017 period:

- smart meter and solar feed-in tariff costs accounted for 16.8 per cent of the bill increase
- RET and VEET costs accounted for 20.6 per cent of the bill increase.<sup>23</sup>

Oakley Greenwood acknowledge RETs and the VEET scheme have put downward pressure on wholesale electricity prices, which is reflected in the wholesale electricity prices shown in their report.<sup>24</sup> However, it is unclear whether RETs, the VEET scheme and solar feed-in tariffs produce a net cost reduction, or whether these policy costs exceed benefits such as lower wholesale prices. It may be difficult to assess this at present—policy costs may be largely incurred upfront while benefits accrue over time.<sup>25</sup>

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<sup>22</sup> Ibid 129.

<sup>23</sup> Oakley Greenwood, *Causes of residential electricity bill changes in Victoria, 1995 to 2017*, February 2017, 11-12.

<sup>24</sup> Ibid 15.

<sup>25</sup> Ibid 15.

These policy measures also have non-price benefits. RETs, the VEET scheme and solar feed-in tariffs are primarily aimed at reducing demand for fossil fuel-based generation, encouraging greater renewable energy generation, and reducing emissions. We note the Essential Services Commission is legislatively obliged to consider the social and environmental value of distributed solar generation when setting the Victorian solar feed-in tariff.<sup>26</sup>

Along with other community organisations, VCOSS is separately exploring policy options for equitable allocation of environmental scheme costs. Although that issue is beyond the ACCC's remit, it is important to recognise any disproportionate cost allocations between low income and more affluent households in an analysis of retail price increases and their causes. If environmental scheme costs are inequitably allocated to people on low incomes, they will bear an even greater price burden in future as the scale of household solar expands and RET costs potentially change.

## Retail costs

### Recommendation

Examine the reasons for Victoria's high retail costs, and whether low income households are disproportionately funding those costs via standing and non-discount market offers.

The available data suggests retail costs (along with environmental scheme costs) have been the major cause of Victorian electricity price increases over the past decade. Between 2008 and 2016, retail costs were estimated to be the second largest contributor to price increases (after government policy/environmental scheme costs). Between 2008 and 2017 the contribution of retail costs was less, which appears to reflect the greater contribution of wholesale costs to the most recent electricity price increases.<sup>27</sup>

Retail costs are high in Victoria compared to other states and territories. As a proportion, retail costs comprised 37 to 44 per cent of standing offer bills in Victoria in 2016, and 21 to 29 per cent of market offer bills—some of the highest retail components in the NEM.<sup>28</sup> As at February 2016, Victoria had the highest retail costs among NEM jurisdictions with deregulated electricity markets, as Figure 1 below shows.

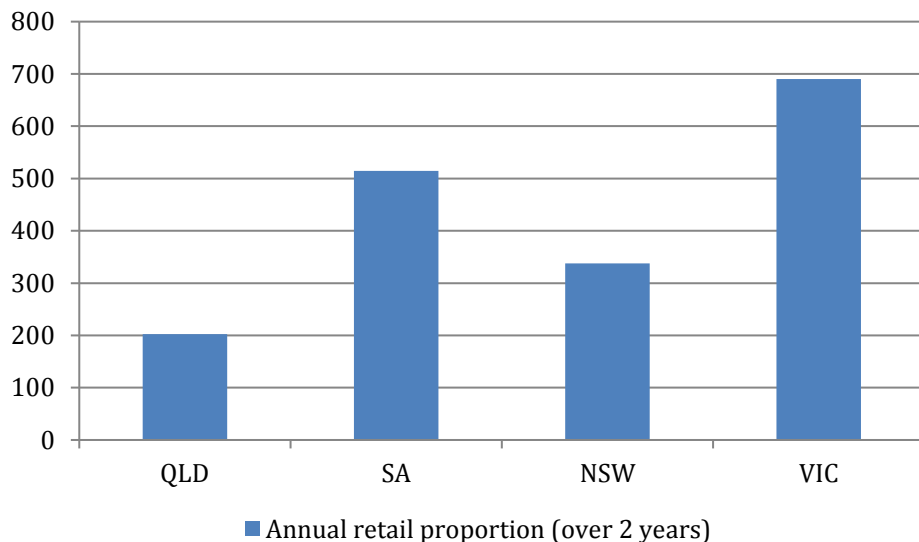
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<sup>26</sup> See Essential Services Commission, *Minimum electricity feed-in tariff to apply from 1 July 2017—Decision (final)*, February 2017.

<sup>27</sup> Oakley Greenwood, *Causes of residential electricity bill changes in Victoria, 1995 to 2017*, February 2017, 11-12.

<sup>28</sup> St Vincent de Paul Society and Alviss Consulting, *The NEM: A hazy retail maze—Observations from Vinnies' tariff-tracking project*, December 2016, 18-20.

**Figure 1: Estimated average annual retail component for customers that stay with retailer for 24 months, based on annual bill for new customer as of February 2016, 6,000 kWh per annum, single rate, GST excluded**



Source: St Vincent de Paul Society and Alviss Consulting<sup>29</sup>

As St Vincent de Paul Society comments:

In Victoria, the jurisdiction with the most active retailers, the retail proportion of bills is significantly greater than in other jurisdictions. While all markets with rivaling suppliers may be called competitive, these charts alone clearly warrant some questions about what is going on in Victoria.<sup>30</sup>

It is not clear why retail costs are higher in Victoria than other states and territories. One explanation is because Victoria is the least concentrated electricity market, competition costs are higher, including customer and acquisition retention costs. Also, in a market with many electricity retailers there are reduced economics of scale and cost savings in areas such as customer service and billing.<sup>31</sup> The Grattan Institute found retail electricity marketing costs are substantial, estimating Victoria's residential electricity customers are collectively paying about \$120 million a year to 'cover the costs of retailers shuffling (or trying to prevent the shuffling of) households around the electricity market'.<sup>32</sup> It is unclear whether marketing and other competition costs produce a net benefit for people in the form of lower prices and/or greater innovation in retail product offerings (to the extent this is possible in a market for a homogeneous good).

<sup>29</sup> Ibid 34.

<sup>30</sup> Ibid.

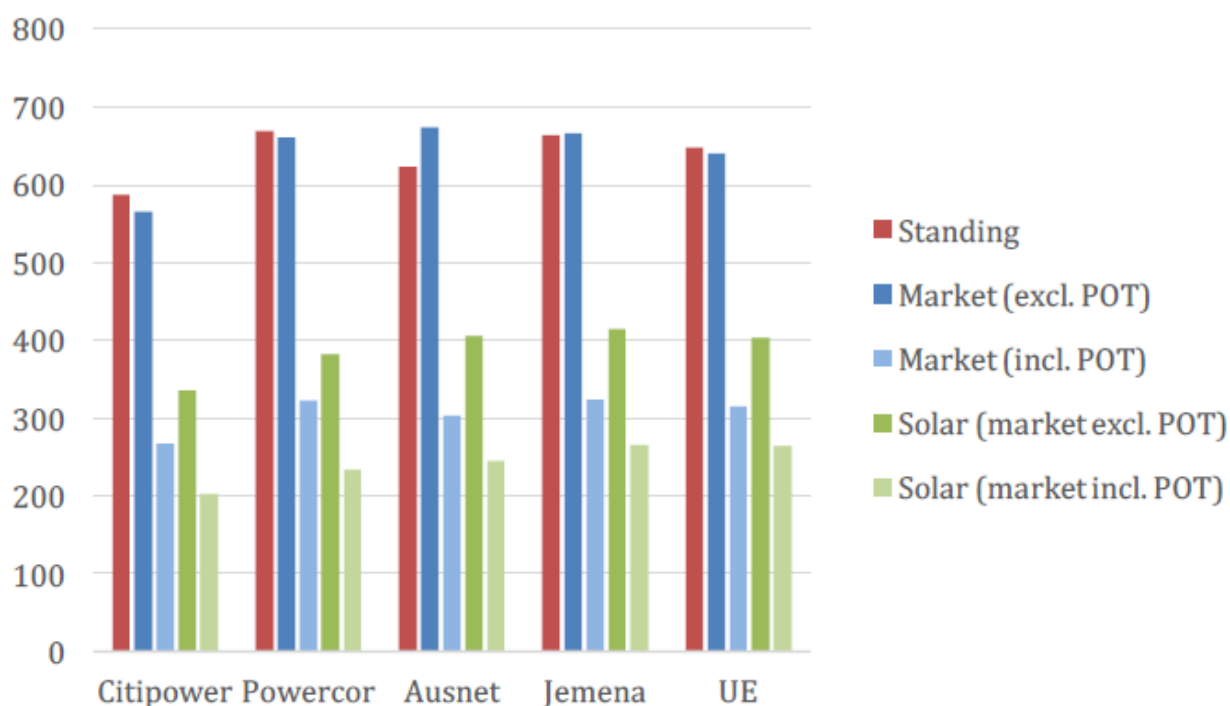
<sup>31</sup> T Wood, D Blowers and G Moran, *Price shock: Is the retail electricity market failing consumers?*, Grattan Institute, 2017, 14.

<sup>32</sup> Ibid 14.

## People on low incomes are more likely to bear the brunt of retail costs

VCOSS is concerned people on low incomes are more likely to be paying a greater share of their bill towards retailer revenue than other households. This is because we anticipate low income households are more likely than other households to be on standing offers and market offers without pay-on-time discounts (due to entrenched barriers to switching among low income and vulnerable households, such as language barriers, major health issues, family violence, or chaotic living circumstances, or because low or irregular incomes prevent people taking up or complying with cheaper pay-on-time discount market offers). People on standing offers and non-discount market offers pay the most towards retailer revenue as a proportion of their bill, as Figure 2 below shows.

**Figure 2: Retail component (\$) of annual bills as of January 2017 for Victorian electricity standing offers, market offers and solar offers, 4,800 kWh per annum, single rate**



Source: St Vincent de Paul Society and Alviss Consulting<sup>33</sup>

Figure 2 reveals retail costs are the highest for standing and non-discount market offers, ranging from just under \$600 to almost \$700 per year. The retail component is significantly less for solar customers on non-discount market offers, followed by 'general' pay-on-time discount market offers available to all customers. Solar customers on pay-on-time discount offers contribute the lowest share to retailer revenue, as a proportion of their bills.

<sup>33</sup> St Vincent de Paul Society and Alviss Consulting, *Victorian Energy Prices, January 2017*, 2017, 72.

Based on the available data, we suggest the ACCC's examination of Victorian retail prices should particularly focus on its uniquely high retail costs, including whether the nature and structure of Victoria's competitive retail market is a factor in those costs, and whether low income households are disproportionately funding those costs via standing and non-discount market offers.

## Lack of pricing and cost transparency

### Recommendation

Establish data collection requirements in relation to the cost components of retail electricity pricing, the causes of price changes, and customer outcomes in retail electricity markets on an ongoing basis.

Like many community sector organisations, VCOSS struggles to precisely identify the causes of electricity price increases. There is very little publically available information about retailer costs and margins or how much they contribute to retail prices, as the Finkel review observed.<sup>34</sup>

We are confident the ACCC inquiry will go a long way towards identifying the causes of price changes, but note price changes and their causes could be more easily identified and tracked in future if the ACCC (along with other energy regulators) establishes more extensive, consistent data collection requirements, including in relation to:

- retail price changes, covering both standard offers and market offers
- long-term trends in wholesale, network, environmental scheme and retail costs
- the composition of retailer costs, including the 'costs of competition' such as customer acquisition and retention
- the proportion of customers on each type of offer, including discount and non-discount market offers
- demographic features of customers on each type of offer, including concession status.

In the absence of comprehensive data about the causes of retail price changes and customer outcomes, it is difficult to develop policy that directly addresses the reasons for unsustainable price increases and unfair customer outcomes.

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<sup>34</sup> *Preliminary Report of the Independent Review into Future Security of the National Electricity Market*, Commonwealth of Australia, 2016, 45.

# Confusing, unclear pricing

Pricing in the Victorian retail electricity market is not transparent, hindering competition. VCOSS asks the ACCC to consider how electricity price representations can be made more transparent and comparable, including through a comparison rate model.

Energy pricing is also obfuscated by the widespread use of 'benefit periods' in Victoria, which are distinct from the contract period and generally only last around 12 or 24 months. We ask the ACCC to consider whether 'benefit periods' might constitute unfair contract terms or misleading or deceptive conduct.

VCOSS is also concerned about the lack of transparency in the composition of the fixed charge, with retail costs sometimes making up a large proportion of the fixed charge in Victoria. Retail costs are potentially shielded from competition when they are hidden in the fixed charge.

## Pricing representations in Victoria

### Recommendation

Consider how electricity price representations can be made more transparent and comparable, including through a comparison rate model.

The majority (around 90 per cent) of Victorian electricity customers are estimated to be on market offers. The ESC estimates that of the market offers:

- 56 per cent are conditional discount offers, which generally require people to pay on time to receive the discount
- 26 per cent are online offers, which may also include discounts
- 18 per cent are set-price offers that do not include discounts for paying on time.<sup>35</sup>

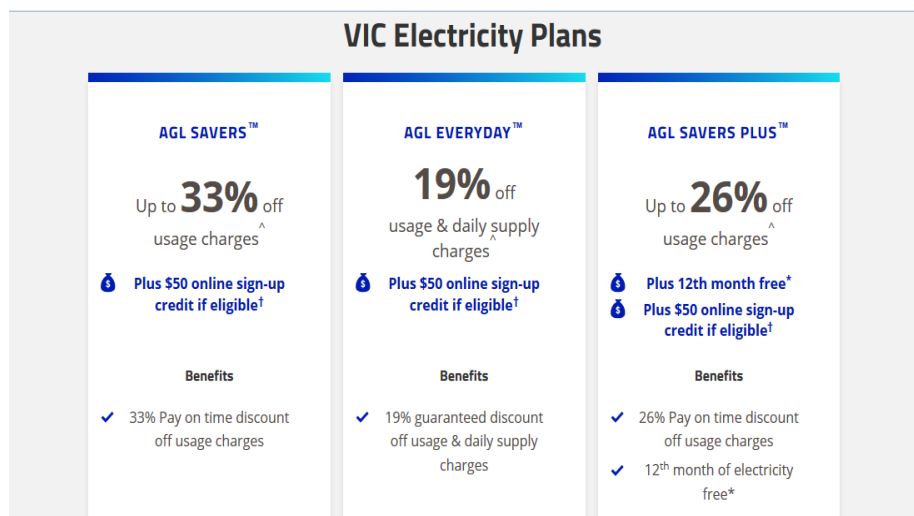
Current discount levels create the impression of a good deal. For electricity it is common to see discounts of 20 to 30 per cent off usage/consumption charges. However, it is very difficult to assess whether these discounts constitute competitive, good value deals when retailers are allowed to display only the headline discount percentage and no other information, such as an indicative final price. The example in Figure 3 is taken from the AGL website.

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<sup>35</sup> Essential Services Commission, *Victorian Energy Market Report 2015-16*, November 2016, 14.



**Figure 3: AGL Victorian electricity offers**



Source: <https://www.agl.com.au/residential/energy-plans/electricity-and-gas-plans> (29 June 2017)

A large discount would seem a good deal to most people, but may in fact be a poor deal if the discount is applied to an inflated base rate and the final rate is uncompetitive. There can be little correlation between the size of the discount and the bill amount (see Figure 4 below).

**Figure 4: Average monthly electricity bill (\$) and advertised discount (%)**



Notes: Average monthly bill is calculated from a representative Victorian household using 4273 kWh electricity per year. All discounts are included in the monthly bill amount. Electricity rates accessed for a household in the Citipower distribution zone. Source: Grattan Institute<sup>36</sup>

<sup>36</sup> T Wood, D Blowers and G Moran, *Price shock: Is the retail electricity market failing consumers?*, Grattan Institute, 2017, 28.

In this analysis, people on the non-discount deal paid slightly less than those on the 30 per cent discount deal. Further, the 10 per cent discount deal is in fact one of the better value discount deals, but may not appear that way to customers when they are presented with discounts of 20 to 30 per cent or more elsewhere in the market.

Current pricing displays make it difficult to determine which deal offers better value. They also make it hard to assess the risk of pay-on-time discount deals, if a person cannot pay on time. In 2015-16, people would have paid less for electricity if they were on a standing offer or an undiscounted market offer, than a discount offer they could not comply with by paying on time (see Table 1).

**Table 1: Average electricity costs, Victoria, 2015-16**

Energy offer type	Annual average residential electricity bill (4000 kWh), 2015-16
Standing offer	\$1376
Undiscounted market offer	\$1306
Discounted market offer (discounts not applied)	\$1383
Discounted market offer (discounts applied)	\$1137

Source: adapted from Essential Services Commission<sup>37</sup>

A low income household can face financial stress and hardship if they are not properly informed about the actual prices they are likely to pay for electricity, including the risks of high bills under a discount offer if they cannot pay on time. The current inquiry should consider how retailers' price representations can be reformed, in order to show consistent, unambiguous displays of estimated electricity prices. If an energy offer represents a good value, competitive deal, easily comparable, estimated actual prices can reveal it.

It is not sufficient for actual pricing to be displayed only once a household has submitted their individual network, usage and other details, whether through a retailer's website or the Victorian Energy Compare online comparator tool. Uptake of Energy Compare is low,<sup>38</sup> and people facing disadvantage can face particular barriers in using the service, such as low literacy levels, no computer or internet access, or language barriers.

We recommend the ACCC consider some form of electricity comparison rate. We acknowledge this will be more difficult in the electricity industry than many other industries, because prices vary based on consumption level, network area and different types of tariffs (e.g. single rate, time of use tariffs). However, these challenges are not insurmountable. Ofgem has developed a tariff comparison rate based on per kWh rates. This rate represents the cost of a tariff for a typical

<sup>37</sup> Essential Services Commission, *Victorian Energy Market Report 2015-16*, November 2016, 19.

<sup>38</sup> Australian Energy Market Commission, *Retail competition review*, Final report, 30 June 2016, 52-53.

consumer, assuming a medium level of energy usage, and includes the unit rates, standing charges and discounts that apply to a given tariff. It can be used as a first point of comparison when comparing tariffs. As the Grattan Institute notes, 'establishing a single comparable rate would enable the majority of customers, who are simply looking for the best single-rate tariff, to find the information quickly and easily.'<sup>39</sup>

Per unit comparison rates are superficially attractive, permitting electricity prices to be compared like other common household goods such as groceries and petrol. However, per kWh units may not be easily understood by consumers, and this requires further investigation.

Comparison rates could instead be estimated for a particular time period (e.g. an annual price), based on different household consumption profiles (e.g. low, medium and high) or a single, average household consumption profile.

Where the electricity offer incorporates a conditional discount (usually a pay-on-time condition), two rates can be displayed: the rate if a person pays on time, and the rate if a person does not pay on time. This reform would help people assess whether conditional discount offers represent good value compared with other offers.

Comparison rates should have to be used by retailers, third-party comparison sites, third-party marketers or brokers, and other channels through which electricity offers are promoted or sold.

VCOSS considers comparison rates would have similar benefits to grocery unit pricing, as identified by the ACCC in its grocery retail prices inquiry. These include:

- making it easier for people to acquire and process pricing information
- assisting people to engage in a meaningful price search
- increasing people's understanding of relative prices offered by one particular retailer, and among retailers
- enabling people to assess the value of product changes.<sup>40</sup>

Comparability of a single retailer's offers is just as important as inter-retailer comparability. AER analysis shows people could get a better deal if they were better informed about their current retailer's offers. In Victoria over the past 12-18 months, a retailer's market offers averaged 17 to 22 per cent lower than the same retailer's standing offer. In other jurisdictions, market offers averaged 8 to 13 per cent lower than standing offers.

A typical customer switching from an electricity standing offer to the best market offer with the same retailer could save up to \$676 in Victoria, far in excess of New South Wales (\$381), South Australia (\$332), Queensland (\$256) and the Australian Capital Territory (\$204).<sup>41</sup>

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<sup>39</sup> T Wood, D Blowers and G Moran, *Price shock: Is the retail electricity market failing consumers?*, Grattan Institute, 2017, 32.

<sup>40</sup> Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, Commonwealth of Australia, July 2008, 450-451.

<sup>41</sup> Australian Energy Regulator, *State of the Energy Market: May 2017*, 2017, 147.

Having improved the transparency and comparability of grocery retail pricing, we consider it even more important the ACCC investigate comparison rates or other ways of improving price representations in the retail electricity market, given the role of electricity as an essential service and the complexity involved in working out the value of electricity offers.

## Ambiguous ‘benefit periods’ and subsequent pricing

### Recommendations

Investigate whether benefit periods may constitute misleading or deceptive conduct, or an unfair contract term, under the *Competition and Consumer Act 2010* (Cth).

Seek industry data on customer outcomes at the end of benefit periods.

Discount offers are generally only available during a ‘benefit period’ that typically lasts 12 or 24 months. The benefit period is distinct from the contract period. A person could be on a contract with no fixed term, but a defined (say 12 month) benefit period. Ongoing contracts with limited benefit periods are becoming increasingly common in Victoria.

Benefit periods seem to have been started by the three major Victorian retailers in 2013, and have since become widespread across the NEM.<sup>42</sup>

Benefit periods create problems for people in a number of ways, particularly people who struggle to engage with the electricity market. First, while the Victorian Energy Retail Code regulates market contracts, it does not specifically regulate benefit periods. There are individual, inconsistent and confusing practices among retailers in relation to:

- pre-contract communications with customers about the nature and length of the benefit period, and what will happen at the end of the benefit period
- whether, and how, retailers notify customers when the benefit period is about to end
- whether customers are automatically placed on new tariffs at the end of the benefit period, which can include standing tariffs
- whether retailers give customers an opportunity to consider their options prior to the end of the benefit period, whether this is an additional benefit period, a new contract, a standing tariff or other arrangement
- how retailers communicate end-of-benefit-period options and price changes—some retailers only list options over the phone (requiring people to make a quick, on-the-spot decision) and do not provide them in writing.<sup>43</sup>

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<sup>42</sup> St Vincent de Paul Society and Alviss Consulting, *The NEM: A hazy retail maze—Observations from Vinnies’ tariff-tracking project*, December 2016, 53.

<sup>43</sup> See further *ibid* 50-54.

Without this information, people cannot assess the risks of benefit period deals, and may agree to revert to a poor value deal after a relatively short 12 or 24 month period.

Second, there is limited transparency around pricing and customer outcomes at the end of benefit periods and contract terms. It seems some customers revert to standing offers, while others may be placed on 'off-market' offers generally not visible to electricity customers. As the AER notes, 'discounts in market offers tend to be finite ... Customers who do not switch regularly may find themselves moving back to prices closer to standing offer levels'.<sup>44</sup> We do not know how many people are on relatively expensive ongoing contracts with lapsed benefit periods.

The use of benefit periods is confusing and potentially misleading, obscuring the prices actually paid under the contract and the duration of discounts or other aspects of an energy offer. They also deter switching where the difference between the benefit period and the contract term is misunderstood and people believe they are receiving the same deal after a benefit period has expired.

VCOSS has asked the Victorian government's Retail Markets Review to consider prohibiting benefit periods in Victoria under the Energy Retail Code or the *Electricity Industry Act 2000* (Vic) and the *Gas Industry Act 2001* (Vic). It would be clearer for people if 'a contract is a contract', with any benefits lasting over an entire contract term (even if this is only a 12 or 24 month term), and making it clear when people will need to consider switching. The current use of benefit periods does not appear to be necessary to protect retailers' interests—if a certain price or benefit can only be maintained for a particular period, this can be managed by limiting the contract term to a certain length.

Separately to the Victorian review, VCOSS asks the ACCC to consider whether 'benefit periods', as they are used in Victorian electricity contracts, may constitute misleading or deceptive conduct, or an unfair contract term, under the *Competition and Consumer Act 2010* (Cth).

## Unclear and potentially uncompetitive fixed charges

### Recommendation

Consider whether there is a lack of transparency around the composition of fixed charges and whether the fixed charge should be based on network and policy costs only.

Another issue in the Victorian retail market is the high retail component of the fixed charge. For example, in one analysis of an Origin Energy market offer in the Citipower network, 53 per cent of the fixed charge was retailer costs, which far exceeded network and smart meter costs, the other

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<sup>44</sup> Australian Energy Regulator, *State of the Energy Market: May 2017*, 2017, 16.

components of the fixed charge. This analysis also shows Victoria has relatively high fixed retail costs compared to other deregulated NEM jurisdictions.<sup>45</sup>

While we acknowledge each retailer has a range of fixed costs relating to billing, customer service and other factors, it is difficult to see how a retailer's fixed costs could be more than double the proportion of network fixed costs, given the extensive expenditure involved in operating networks.

Despite the large share retailers can take in fixed charges, some retailers give customers the impression the fixed charge relates only to network costs.<sup>46</sup> We ask the ACCC to examine whether there is a lack of transparency around the composition of fixed charges, and whether the inclusion of retail costs in the fixed charge makes it more difficult for total retail costs to be subjected to competition. If this is the case, people may be paying more than they need to for electricity. This includes low consumption households (such as sole adult pensioner households) who are frustrated they still have unaffordable electricity bills due to high fixed charges. If there is a lack of competition around total retail costs, we seek the ACCC's views on whether this could be rectified by requiring retailers to base the fixed charge on network and policy costs only and incorporate all retail costs into the consumption charge.

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<sup>45</sup> St Vincent de Paul Society and Alviss Consulting, *The NEM: A hazy retail maze—Observations from Vinnies' tariff-tracking project*, December 2016, 27-30.

<sup>46</sup> *Ibid* 29.

## Consumer education has its limits

Buying electricity in Victoria is daunting. The Victorian government's Energy Compare comparator website has made the process somewhat easier and allowed people to access objective information about energy deals. However, Energy Compare use requires computer and internet access, computer literacy skills, general literacy skills, English familiarity, and the space and time to search for better electricity deals. Devoting a lot of time to buying electricity may not be a priority, or even possible, where a person is experiencing family violence, major health problems or mental illness, housing problems, overwhelming financial stress or other problems and life crises.

People experiencing vulnerability face considerable barriers to engagement. Vulnerable people tend to have lower awareness of the number of retailers, and the availability of various plans from a single retailer. Most vulnerable people are concerned about prices but feel there is not much they can do. Fear of making the wrong decision and embarrassment about personal financial situations are barriers to investigating options and switching. Many vulnerable people want to save money but find the array of offers confusing, and lack the time and energy to properly engage with the market and find a better offer. Research suggests most vulnerable people require a noticeable trigger event to search for better deals, including the shock of receiving an unexpectedly large bill, moving house, reaching the end of a contract or increased prices.<sup>47</sup>

VCOSS regularly consults with members about energy issues. VCOSS members report people are increasingly worn down by the process of buying energy and trying to understand their bills. Qualitative research conducted by RMIT for VCOSS (forthcoming, July 2017) shows people feeling frustration, anger, disadvantage and/or powerlessness as energy buyers. Some people interviewed for that study felt the time required to understand tariffs and their rights was unreasonable.

A UK study of vulnerable households showed independent, one-on-one, personalised intervention encourages switching, particularly for young families. The 'intervention' took the form of tailored advice on tariff-switching, printed information materials, help accessing websites, and follow-up support. This type of assistance was particularly necessary for people experiencing complex lives, including significant health and financial problems. In these circumstances, time is limited and tariff-switching far from a priority.<sup>48</sup>

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<sup>47</sup> Newgate Research, *AEMC 2016 retail competition review: Understanding vulnerable customer experiences and needs*, Consumer research report, June 2016, 6-8.

<sup>48</sup> A Lorec, L Pedro, B Badesha, C Dize, I Fernow, L Dias, 'Tackling fuel poverty through facilitating energy tariff switching: A participatory action research study in vulnerable groups' (2013) 127 *Public Health* 894.

However, even these types of strategies to improve engagement have their limits. In an RMIT study of households with children, people had low engagement with tariff and retailer choice. Many parents had little time, interest or trust to investigate tariff choice and energy information. The researchers concluded that providing more information through websites or printed materials was unlikely to resolve the issue.<sup>49</sup>

While some groups of people will continue to benefit from consumer education and engagement strategies, the electricity market needs to cater to people who face insurmountable barriers to engagement and being a ‘better consumer’. Not everyone has the skills and resources to engage with the market. It is time for the ‘mountain to come to Mohammed’ and take some of the hard work out of buying electricity. Transparent pricing can help, along with introducing an independent energy broker.

## Independent energy broker

### Recommendation

Examine the benefits of an independent energy brokerage service for residential customers.

Similar to previous reports, the AER observes ‘while concessions represent an important saving for eligible households ... many households can achieve significant savings just by switching to a cheaper offer’.<sup>50</sup> For the reasons we have noted, some low income or disadvantaged households will find it difficult to identify cheaper offers and switch retailers.

To improve competition and provide better access to more affordable energy offers, VCOSS recommends consideration of an independent energy broker for residential customers. Separately, the Victorian government has funded in the 2017-18 budget a small-scale energy brokerage pilot scheme aimed at assisting people in hardship programs and people from culturally and linguistically diverse backgrounds. In tandem with transparent energy pricing, we consider an independent energy broker (for all energy customers) can provide one-on-one, personalised supports, in a similar way to emerging private brokerages in Victoria, such as the ‘Energy Tailors’ service. An independent broker could:

- encourage greater price competition by providing a relatively easy and no-cost way for people to compare energy offers, particularly for people who cannot use the Energy Compare service—in effect, it can create the marketplace that Energy Compare may not be able to create as a price comparison website alone
- encourage switching and help counteract people’s inertia and bias by giving them confidence to take up better-priced energy offers (people would know that all available

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<sup>49</sup> Larissa Nicholls and Yolande Strengers, *Changing demand: Flexibility of energy practices in households with children—Final report*, Centre for Urban Research, RMIT University, January 2015.

<sup>50</sup> Australian Energy Regulator, *State of the Energy Market: May 2017*, 2017, 151.



offers in the market had been analysed), conducting regular ‘check-ups’ to search for better deals, and assisting with the switching process itself<sup>51</sup>

- assist professionals who already have contact with people experiencing energy difficulties, but are unable to assist with searching and switching, including health workers, financial counsellors, and community caseworkers
- conduct proactive searches for people receiving concession discounts and provide information about better value energy deals. At the moment, government is subsidising the costs of relatively poor value energy offers
- conduct proactive searches for ‘disengaged customers’; that is, those who have not been active in the market for a certain amount of time (this would require sharing customer data with the broker)
- search for energy offers at the end of benefit or contract periods. This could involve mandating retailers to refer people to the energy broker at the end of these periods—a particularly important function given the ambiguity surrounding benefit periods and pricing under contracts with lapsed benefit periods
- provide feedback to government on the level of pricing transparency in the market and ease of comparability
- generate data about customer outcomes in the market.

An energy broker could also help overcome people’s limited ability to understand tariff structures (fixed and usage charges, time-of-use rates and so on); the difference between market and standing offers; choice of retailers; the various plans offered by an individual retailer; and household energy requirements.<sup>52</sup>

The ACCC could examine whether a brokerage model could improve people’s understanding of electricity offers, overcome fundamental barriers to market engagement for people facing disadvantage, enable greater price transparency, and facilitate competition and more affordable electricity pricing.

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<sup>51</sup> On inertia and bias in the energy market see Oxera Consulting, *Behavioural insights into Australian retail energy markets*, prepared for the Australian Energy Market Commission, 11 March 2016, 19-24.

<sup>52</sup> On these barriers to people’s engagement with the market see *ibid* 19-24.

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