Victorian Default Offer
Expert Panel

Report on the initial market outcomes since the introduction of the Victorian Default Offer

Claire Thomas
Kris Funston
Catriona Lowe

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Contents

Glossary ............................................................................................................................ ii
Acronyms ......................................................................................................................... iii
Summary .......................................................................................................................... iv

1. Introduction ................................................................................................................... 5
  1.1 Background ................................................................................................................ 5
  1.2 Implementation of the VDO and related retail electricity market reforms .......................5
  1.3 Default Market Offer .................................................................................................. 6
  1.4 Report structure ......................................................................................................... 7

2. Panel assessment of VDO’s initial impacts ............................................................ 8
  2.1 Time and data constraints ........................................................................................ 8
  2.2 Assessment criteria applied by the Panel .................................................................... 9
  2.3 Panel findings ............................................................................................................ 9
    2.3.1 Has the VDO become a floor price? ................................................................ 9
    2.3.2 Has there been a disproportionate loss of benefits for active consumers? ........... 10
    2.3.3 Has there been increased industry concentration, substantially lessening retail
        competition? .........................................................................................................14
    2.3.4 Have retailers lowered service quality in order to reduce costs? .........................14
    2.3.5 Have the benefits of the VDO been outweighed by the costs to active consumers? ...14
    2.3.6 Have consumers who would benefit failed to access the VDO? ......................... 15

3. Comparing the VDO and DMO ............................................................................. 17
  3.1 Background .............................................................................................................. 17
  3.2 Differences between the VDO and DMO ................................................................ 17
  3.3 Initial impacts of the VDO and DMO ..................................................................... 18
    3.3.1 Standing offer prices reduced from 1 July 2019 .................................................. 19
    3.3.2 Highest priced market offers are mostly lower than in 2018 ............................... 19
    3.3.3 There has been a notable reduction in price dispersion from tier 1 retailers .......... 19
    3.3.4 There has been a noticeable shift away from conditional discounts since 1 July .........20

4. Conclusions .............................................................................................................. 21

Appendix A Retailers included in this analysis ............................................................... 22
Glossary

**Conditional discount** – a discount off an energy bill if the customer abides by a certain condition in their contract, such as paying their bill on time, or by direct debit.

**Default Market Offer (DMO)** – a federal government-initiated default electricity price for residential and small business customers in force in New South Wales, South-east Queensland and South Australia.

**Headroom** – an allowance in a regulated price that does not reflect a cost borne by firms operating in the market, generally used to attract competitors when markets are in the process of being deregulated. A key difference between the DMO and VDO is that the DMO has an allowance for headroom.

**Market offer** – these are offers that energy retailers set – their competitive offers. They may offer a discount (or some other benefit) and can vary in length or be ongoing.

**Standard offer** – an offer that retailers are required to make available and publish as per the Electricity Industry Act 2000 the Gas Industry Act 2001.

**Tariff** – the total price charged for electricity or gas. The tariff includes at least two parts:
- Fixed charge – also called the daily supply charge, or the service charge
- Variable charge – for the amount of energy you use, also called the consumption charge

**Unconditional discount** – or non-conditional discount, is a discount a customer receives automatically on a market contract without conditions attached.

**Victorian Default Offer (VDO)** – a default electricity price for residential and small business customers in Victoria.
Acronyms

ACCC – Australian Competition and Consumer Commission
AEMC – Australian Energy Market Commission
AER – Australian Energy Regulator
ESC – Essential Services Commission
VEC – Victorian Energy Compare
Summary

On 1 July 2019 the Victorian Government introduced the Victorian Default Offer (VDO) - a default electricity price for residential and small business customers in Victoria. One of a suite of reforms to Victoria’s retail energy markets foreshadowed in the Government’s Energy Fairness Plan, the aim of the VDO is to:

… provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the retail electricity market without impeding the consumer benefits experienced by those who are active in the market

On the same day as the VDO was introduced in Victoria, a federal government initiated Default Market Offer (DMO) came into force in NSW, South-east Queensland and South Australia.

The VDO Expert Panel (the Panel) was asked by the Minister for Environment, Energy and Climate Change to monitor the early impacts of the VDO. This report sets out our observations on initial changes to Victoria’s retail electricity market over the period 1 July to mid October 2019, based on publicly available information.

While it is too early to reach definitive conclusions as to whether the VDO is achieving the government’s policy objectives, the early signs are encouraging. In particular:

- despite industry concerns that the VDO would become a ‘floor’ price, this has not occurred
- active customers are still able to benefit from a (narrower) range of lower priced offers
- there has been a trend away from conditional discounting
- fears that that the VDO would be set so low as to force a number of retailers to exit the market, threatening ongoing competition, have also waned - indeed there is evidence that new retailers remain interested in entering the market
- there are early signs that, relative to the DMO, the VDO may be exerting greater downward pressure on prices paid by all customers, not just those on standing offers, and
- a number of customers are saving as a result of the introduction of the VDO. New and forthcoming policy initiatives should also help raise awareness of the VDO and information gathering by the Essential Services Commission (ESC) will provide insight into what customers are actually paying.

The Panel’s ability to draw definitive conclusions about the overall impact of the reform on Victorian consumers is nevertheless constrained by limits on available information. To determine the overall impact of the VDO on consumers, we would need information on the actual tariffs and annual bills incurred by non-standing offer customers, and how these may have changed since the period prior to 1 July. As this information was not available in time for this report, we have had to rely on publicly available information on retail market offers in monitoring the initial market impacts of the VDO.

The Panel is also mindful that just four months have elapsed since the introduction of the VDO. The market is still adjusting to the change and it is too early to say whether current trends will be sustained. We are also aware that the impacts of complementary reforms are yet to play out. For example, a requirement that retailers advise customers on how to access the VDO has only been in place since 1 October 2019, while measures to ensure fairer contract terms will not be introduced until July 2020. Both these reforms have the potential to increase the take-up and impact of the VDO over time.

Accordingly, it will be important to continue to monitor these impacts over the coming months. As information becomes available on actual customer bills before and after the change, a more comprehensive assessment of the overall costs and benefits of the reforms can be undertaken.

Claire Thomas, PSM - Chair
Dr Kris Funston, Partner Deloitte Access Economics
Catriona Lowe, Consumer Advocate and Principal Tractor Consulting

1 Victorian Government 2018, Time is up for energy retailers ripping off Victorians, Media release, November
1. Introduction

1.1 Background

In August 2017, an Independent Review of the Electricity & Gas Retail Markets in Victoria (the Independent Review) commissioned by the Victorian Government found that Victorians were paying more than they should for energy, with retail charges a significant factor in rising energy bills. The review also found that electricity pricing and contract terms lacked transparency and that there was evidence of market failure.

In response to the recommendations of the Independent Review, in October 2018 the Victorian Government released its Energy Fairness Plan, foreshadowing a suite of reforms to Victoria’s retail energy market. This included the introduction of a Victorian Default Offer (VDO) electricity price for all domestic and small business electricity customers in each of Victoria’s five electricity distribution zones.

The aim of the VDO was to provide customers with access to a fair price, based on the efficient cost to run a retail business. Legislation giving effect to the retail market reforms provided for the initial VDO price to be determined by the Minister for Energy, Environment and Climate Change (the Minister).

The ESC was tasked with developing a methodology and recommending a price (or prices) for the initial VDO to apply from 1 July 2019. Among other requirements, the ESC was required to consult publicly and also to engage with an Expert Panel in developing its methodology and recommended VDO price(s).

The VDO Expert Panel was appointed to engage with and advise the ESC and the Minister on the implementation of the VDO; and provide expertise on the VDO methodology and price to ensure that energy markets are simpler and fairer for Victorian consumers. Members of the Panel were selected based on their expertise in energy policy and regulation, consumer advocacy and public policy.

In May 2019, after considering advice from the ESC and the Panel, the Minister announced her decision on the initial VDO price to take effect from 1 July 2019.

1.2 Implementation of the VDO and related retail electricity market reforms

Since 1 July, the VDO has applied by default to all residential and small business customers on flat standing offer electricity contracts at that date. For households with average household usage on standing offer contracts, switching to the VDO was estimated to save between $310 and $450 on their annual electricity bills, depending on their distribution zone. Customers on other types of contract are also eligible to access the VDO should they so choose.

The VDO Expert Panel was tasked with monitoring changes in the retail electricity market in the months immediately following the introduction of the VDO.

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3 Thwaites, J, Faulkner, P & Mulder, T 2017, Independent Review into the Electricity & Gas Retail Markets in Victoria
5 On 26 October 2018, the Victorian Government released its final response to the Independent Review of the Electricity and Gas Retail Markets in Victoria. The Energy Fairness Plan was announced on 20 November 2018.
8 The Governor in Council made an Order in Council under section 13 of the Electricity Industry Act 2000 (Vic.), which was recently amended by the Energy Legislation (Victorian Default Offer) Act 2019, assented to on 26 March 2019.
10 Victorian Government 2019, Saving Victorians hundreds of dollars off their power bills, Media release, May
11 Flat tariffs are tariffs that comprise a usage charge that does not vary at different times of the day or times of year. Non-flat tariffs, such as time-of-use tariffs, comprise a usage charge that differs at different times of day. Standing offers for non-flat tariff types will be subject to a VDO-equivalent price cap commencing from 1 January 2020.
12 Essential Services Commission 2019, Government accepts regulator’s advice on fair electricity price, Media release, May
In addition to monitoring the impact of the VDO on electricity prices, the Panel has been mindful that other reforms introduced from 1 July 2019 may be expected to have influenced retailer behaviour over the ensuing months. These reforms have imposed new requirements on retailers to:

- include a ‘best offer’ on all electricity bills
  - at least quarterly for electricity bills and at least every four months for gas bills, retailers must tell customers on their bill whether they are on the best energy plan and how much the customer could save by switching
- provide clear advice before signing up new customers/offers
  - retailers must help customers navigate to a product that best suits their circumstances
- provide fact sheets for all energy plans
  - all energy plans will have a fact sheet that shows the expected average yearly cost of the plan for a number of typical households
- notify price or benefit changes
  - retailers must notify customers of a price or benefit change at least five business days prior to the introduction, and they must include a ‘best offer’ message telling customers whether a cheaper plan is available, and how much the customer could save by switching
- allow customers to submit self-readings of their meters
  - customers that receive an estimated bill can request an adjustment by submitting a self-read of their meter prior to the bill’s due date.

Further reforms are scheduled to be rolled out over the 12 months to 1 July 2020:

- since 1 October 2019 retailers have been required to include information on electricity bills about how a customer may access the VDO
- from 1 January 2020 non-flat tariff standing offers will default to a new non-flat VDO, and
- from 1 July 2020, following an inquiry by the ESC into energy contract terms, measures are to be introduced to ensure energy contracts are clear and fair.

1.3 Default Market Offer

On the same day as the VDO was introduced in Victoria, a DMO came into effect in New South Wales, South-east Queensland and South Australia. While also a default offer for customers formerly on flat rate standing offers, the DMO differs in important respects from the VDO.

As described in the ESC’s final report on the VDO methodology, whereas the VDO seeks to establish a fair price based on the costs an efficient retailer would face, the DMO is intended to serve as a benchmark price against which customers can compare alternative market offers.\(^{13}\)

A key difference is the allowance for ‘headroom’\(^{14}\) in the DMO (and not the VDO). Nevertheless, the simultaneous introduction of the VDO and the DMO provides an opportunity to make some observations on the initial impacts of the two different electricity default price schemes.

\(^{13}\) Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, May, p.21

\(^{14}\) The ESC has defined headroom as ‘an allowance in a regulated price that does not reflect a cost borne by firms operating in the market.’ The ESC noted that headroom is typically a transitional allowance that is intended to attract competitors when markets are in the process of being deregulated. Source: Essential Services Commission 2019, Victorian Default Offer to apply from 1 July 2019: Advice to Victorian Government, May, p.8
1.4 Report structure

This report sets out the Panel’s observations on the initial changes to Victoria’s retail electricity market since the introduction of the VDO and is structured as follows:

- Section 2 provides an assessment on the initial effectiveness of the VDO against criteria based on the Panel’s consideration of potential risks to the success of the policy.
- Section 3 examines the outcomes across jurisdictions, in particular, contrasting initial outcomes observed from the VDO and the DMO.
- Section 4 summarises the overall findings based on the Panel’s observations of the initial changes to Victoria’s retail electricity market over the period 1 July to mid-October 2019.
2. Panel assessment of VDO’s initial impacts

This section summarises the Panel's assessment of the initial impacts of the VDO policy intervention, based on observed changes in the Victorian retail energy market before and after its introduction.

Early signs are positive, however we emphasise at the outset the inconclusive nature of this assessment due to the time and data constraints under which the Panel was operating, as outlined below.

2.1 Time and data constraints

For this assessment the Panel has relied on data on retailers’ generally available market offers posted on the Victorian Energy Compare (VEC) website, cross-checked against information on individual retailers’ websites. The price of offers provides an indication of how retailers have responded to the introduction of the VDO since 1 July 2019. However, these data do not tell us what customers are actually paying for electricity, nor how this has changed since 1 July 2019.

Because some customers will be on legacy contracts that have different tariffs to those currently available, current price offers are unlikely to reflect whether, or to what extent, the average prices paid by Victorian consumers (other than standing offer customers) has changed since 1 July 2019.

The Panel has also reviewed recently published reports by the Australian Competition and Consumer Commission (ACCC),\(^\text{15}\) Australian Energy Regulator (AER)\(^\text{16}\) and St. Vincent de Paul.\(^\text{17}\) These reports include some analysis of initial changes in the price of market offers in different Australian jurisdictions since the simultaneous introduction of the VDO and the DMO on 1 July 2019 and enable some tentative comparisons to be made.

Nevertheless, our ability to draw definitive conclusions about the overall impact of the reforms to date on electricity consumers is constrained by available information.

In addition, while we appreciate that there is a public interest in reporting as soon as practicable on the impacts of this significant market intervention, we are mindful that it is too early in the process to draw definitive conclusions about the success or otherwise of the VDO and related reforms. Not only is the market still adjusting to the reforms introduced on 1 July 2019, there are still yet to be introduced elements of the reform package. This includes measures to ensure clear and fair contract terms. Combined, these may influence the extent of take-up of the VDO and the overall distribution of costs and benefits from the pricing reforms.

In our view it would likely require the reforms to have been in place for 12 months or more before we could be confident that the trends we have witnessed to date will be sustained.

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15 Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 report
16 Australian Energy Regulator 2019, Affordability in retail energy markets
2.2 Assessment criteria applied by the Panel

To guide its assessment, the Panel identified a set of key criteria against which the effectiveness of the VDO in meeting the Government’s objectives might be assessed. These criteria were based on the Panel’s consideration of potential risks to the success of the policy, risks that were also identified by some stakeholders’ during the ESC’s consultations. These identified risks were as follows:

- The VDO becomes the floor price, with lower priced market offers largely withdrawn
- There is a disproportionate loss of benefits for active consumers relative to those on standing offers
- Increased industry concentration substantially lessens competition
- Retailers respond to the VDO by lowering service quality in order to reduce costs
- The benefits of the VDO to inactive customers are outweighed by the costs to active consumers
- Consumers who would benefit from doing so do not take up the VDO

2.3 Panel findings

The findings of the Panel’s assessment of market responses against these criteria are presented below.

In considering these findings it should be noted that:

- the analysis focuses on retailers’ flat tariff market offers because the VDO set for the period 1 July to 31 December 2019 is restricted to flat tariffs
- the annual bill data underlying the charts presented in this report are based on average household usage (4,000 kWh per annum), and
- while not presented in the analysis in this report, small business customers have faced similar trends in flat tariff market offer prices since 1 July 2019.

2.3.1 Has the VDO become a floor price?

A significant concern raised by industry prior to the introduction of the VDO was that price regulation would spell an end to competitive pricing, with lower priced market offers discontinued and the VDO effectively becoming a floor price.

Based on our observations of pricing offers on the Victorian Energy Compare website, there is no evidence of this occurring. Indeed, almost all retailers have been offering flat rate tariffs below the VDO price since 1 July 2019.

Figure 1 shows the range of annual bill amounts that would result from flat tariff market offers available on 10 October 2019 from each retailer in the Jemena distribution zone. As a number of retailers have more than one flat tariff market offer available, the range of possible bill outcomes is displayed as a vertical green bar. The yellow line in each bar represents the median priced offer available from each retailer. To show where each retailer’s market offer sits relative to the VDO, the horizontal blue line in Figure 1 represents the annual price of the flat tariff VDO in the Jemena distribution zone.

Figure 1 groups individual retailers into ‘tiers’, with tier 1 comprising the largest retailers (Origin Energy, Energy Australia and AGL), tier 2 comprising the mid-size and tier 3 the smaller retailers. The tiers of retailers are based on criteria from the Independent Review using updated market share data from 2017-18. Appendix A lists the retailers included in this analysis and the tier to which they have been assigned.

As Figure 1 shows, most retailers across all tiers currently have at least one flat tariff market offer below, or at, the level of the VDO. Across the distribution zones, the cheapest market offers on 10 October 2019 ranged between $230 and $305 per year below the level of the VDO.
Notably, while no tier 1 retailers currently offer a price higher than the VDO, as a group they are offering a relatively narrower range of unique priced offers than tier 2 and 3 retailers. A few have chosen simply to price according to the VDO, so the price offered acts as both a floor and cap for those retailers.

**Figure 1** Range of estimated household annual bill amounts by retailer, based on flat tariff market offers available in the Jemena distribution zone on 10 October 2019

![Figure 1: Range of estimated household annual bill amounts by retailer, based on flat tariff market offers available in the Jemena distribution zone on 10 October 2019](image)

Source: Data obtained from the Victorian Energy Compare website and cross-checked against retailers’ websites and fact sheets

2.3.2 Has there been a disproportionate loss of benefits for active consumers?

With retailers required to transfer customers on higher priced standing offers to the lower priced VDO from 1 July 2019 it could be anticipated that some retailers would seek to recoup part of the revenue lost as a result of this transfer by discontinuing some lower priced offers previously available to active customers. Provided customers could still achieve lower priced offers by shopping around, such adjustments would be unlikely to amount to a disproportionate loss of benefits for active consumers, particularly given the Independent Review finding that the numbers of active customers achieving the benefits implied in the lowest price offers is likely to have been limited. This is because:

- only consumers who switch regularly and remain engaged in the market achieve the best offers, and
- the benefit drops “sharply” if consumers can only find the second, third or fourth best offer.\(^\text{21}\)

In order to assess whether existing customers have actually suffered any loss of benefits following the introduction of the VDO it would be necessary to access information on the actual prices paid by customers prior to and after 1 July 2019 - information which was not available to the Panel at the time of reporting. However, based on the prices available in the market on 10 October 2019 (as shown in Figure 1), we can conclude that consumers looking for a new electricity offer could still find low-priced offers in the market.

The Panel has also considered how the range of retailers’ market offers has changed over the past year and whether the lower priced offers available in October 2019 are significantly higher than those available in 2018 or early 2019.

Figure 2 presents the range of annual bills that would result from retailers’ posted market offers at different points in time since July 2018. Figure 2 again aggregates retailer data for each retail tier. The vertical bars in Figure 2 represent the difference between the highest and lowest priced market offers each retail tier has made available to households with the average consumption of 4,000kWh of electricity per year. For comparison, the orange horizontal line in Figure 2 represents the annualised price of the VDO, noting that this price has only existed in the market since 1 July 2019.

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\(^{21}\) Thwaites, J, Faulkner, P & Mulder, T 2017, Independent Review into the Electricity & Gas Retail Markets in Victoria, p.ix
A clear trend depicted in Figure 2 has been a narrowing in the range of available prices. This largely occurred between March and July 2019, with the range of available prices stabilising somewhat between mid-July and mid-October 2019. While all retailers appear to have reduced their highest priced offers, tier 1 retailers in aggregate have reduced the range of offers to a narrow band around and slightly below the VDO. By contrast, tier 3 retailers have in aggregate maintained their lower priced offers since the introduction of the VDO and some retailers have even reduced their lower priced offers when compared to July 2018.

It should be noted that, because the data in Figure 2 aggregates market offers from all retailers in each of the tiers, it obscures the differing pricing strategies adopted by different retailers. Indeed, trends within a given tier could theoretically be driven by the behaviour of a single retailer. Importantly, the trends in price ranges depicted in Figure 2 cannot be interpreted as representative of all retailers in a tier. For example, the wider spread of offers from 1 July 2019 within tiers 2 and 3 shown in Figures 1 and 2 was significantly influenced by the pricing strategies of just a few retailers.

A narrowing in the range of prices raises a range of considerations:

- given the homogeneous nature of electricity, a narrower range of prices may be expected than for other more differentiated products
- a continued narrowing of the range of prices could raise competition concerns (however we do not consider that point has been reached), and
- the proliferation of offers in the market can contribute to consumer confusion (discussed further below in relation to conditional discounting).

**Figure 2** Range of household annual bill amounts by retailer type available in the Jemena distribution zone: July 2018, March 2019, July 2019, September 2019 and October 2019

Source: Data obtained from the Victorian Energy Compare website and cross-checked against retailers’ websites and fact sheets
A second clear trend has been a significant move away from conditional discounting since the introduction of the VDO. Whereas 16 businesses previously offered these discounts, now only nine do so, and the range of discounted offers has been significantly reduced. Percentage discounts that currently exist for paying on time are also now much lower than pre-1 July 2019, with the average pay-on-time discount now 8 per cent compared to 23 per cent in July 2018. Whether this represents a net decrease in the discount in dollar terms on the consumer bill depends upon the underlying rate the discount is applied to.

A significant factor behind the shift away from conditional discounting is likely to have been the new requirement that retailers offering discounts must now disclose how their discounts are calculated against the benchmark of VDO tariffs. The ESC is also introducing a new requirement that will cap the costs incurred by customers for failing to meet offer conditions at a level that is not higher than the reasonable cost to the retailer.

The Independent Review, the Australian Energy Market Commission (AEMC) 2018 Retail Energy Competition Review and the ACCC’s 2018 Retail Energy Pricing Inquiry report, all identified discounting behaviour, and conditional discounts, as contributing to negative outcomes for consumers, adding to consumer confusion and/or creating additional complexity of the offers in the market. The ACCC has also pointed out that pay-on-time discounts particularly penalise those consumers that can least afford the penalty of not paying on time. It gave the example of a vulnerable cohort missing out on discounts 59 per cent of the time.

Figures 3 and 4 show the change in retailers’ discounting practices between July 2018 and October 2019. Figure 3 presents historic data at July 2018. Due to the archiving feature of the VEC website, we are unable to differentiate between conditional and non-conditional discounts in historic data. Therefore Figure 3 includes all offers which were noted to have a discount at July 2018. Given market trends, we believe that most discounts at that time are likely to have been conditional although the dataset is unable to distinguish this. For Figure 4, we are able to match the detailed VEC dataset with the VEC annual bill amount and therefore include only offers that have conditional discounts.

Figure 3 shows that in July 2018, 16 retailers were offering discounts against their market offers. For each of the retailers with a range of discounted flat rate contracts on offer at that time, Figure 3 presents two uniquely coloured vertical bars, the first indicating the range of annualised bills for all flat rate offers, including those with discounts (without the discounts applied), and the second showing the range with discounts applied. For retailers with just one flat rate price in the market, annual bill amounts with and without discounts are indicated by a dash.

Figure 3 shows that consumers who failed to meet conditions associated with discounts would have been paying significantly higher prices in July 2018 than those receiving discounts, and that in many cases even discounted prices would have been well above today’s VDO price.

Figure 4 presents data on conditional discounts only as at October 2019, after the introduction of the VDO. It shows that the number of retailers offering discounts has fallen from sixteen to nine and that the size of the discounts has fallen significantly relative to July 2018. Offers from most retailers include relatively smaller price differences for consumers that meet and do not meet the conditions of the offer. This means that consumers that fail to meet their discounts on these offers will face a much lower financial penalty.

Rather than a disproportionate loss of benefits the Panel considers that active consumers may receive positive benefits from the greater pricing transparency that is resulting from the shift away from non-comparable discounts between retailers and conditional discounts attached to market offers.

24 Australian Competition and Consumer Commission 2018, Restoring electricity affordability and Australia’s competitive advantage: Retail Electricity Pricing Inquiry - Final Report, June, p.259
25 Australian Competition and Consumer Commission 2018, Restoring electricity affordability and Australia’s competitive advantage: Retail Electricity Pricing Inquiry - Final Report, June, p.253
26 Australian Competition and Consumer Commission 2018, Restoring electricity affordability and Australia’s competitive advantage: Retail Electricity Pricing Inquiry - Final Report, June, p.264
27 Australian Energy Market Commission 2018, Retail Energy Competition Review, p.54, noted that as at March 2018, of the 5,940 electricity and gas offers across the national electricity market regions, which includes Victoria, 57 per cent had a least one conditional discount
Figure 3  Range of household annualised bills for flat tariff offers, without and with discounts applied, in the Jemena distribution zone in July 2018

Source:  Data obtained from the Victorian Energy Compare website
Note:  For this dataset, we were unable to differentiate between conditional and unconditional discounts

Figure 4  Range of household annualised bills for flat tariff offers, without and with discounts applied, in the Jemena distribution zone in October 2019

Source:  Data obtained from the Victorian Energy Compare website and cross-checked against retailers’ websites and fact sheets
2.3.3 Has there been increased industry concentration, substantially lessening retail competition?

There is no evidence to date of the market becoming more concentrated since the introduction of the VDO. Had this occurred, we would see an increase in market exits or a stalling of market entry.

However, there are early signs that retailers continue to be keen to enter the Victorian market. While the ESC has not granted any new small customer retail licences since 1 July 2019, Kogan Energy has commenced offering retail electricity and gas products to Victorian households under Powershop’s retail licence.28

In addition, while market entry and exit are useful indicators of the level of competition in the market, we note that evidence of retailers’ exiting the market would not, of itself, indicate that the VDO has had adverse effects on retail competition. Rather, any given market exit might reflect poor management or an unsustainable business model.

2.3.4 Have retailers lowered service quality in order to reduce costs?

While it is too early to conclude whether retailers will respond to the introduction of the VDO by lowering service quality (such as call centre staffing) in order to reduce operating costs, the Panel has not seen any evidence to date of this occurring.

For example, the Panel has been advised that the Department of Environment, Land, Water and Planning has received 27 consumer enquiries related to the VDO since 1 July 2019, none of which indicate significant issues with service quality reductions.

2.3.5 Have the benefits of the VDO been outweighed by the costs to active consumers?

A full assessment of the distribution of costs and benefits of the VDO will only be possible when data becomes available comparing actual bills paid by different classes of customer before and after its introduction.

However, some preliminary observations can be made. For the purposes of our assessment, we identified four broad groups of customers and considered how prices may have changed for each of those groups. The Panel’s observations are set out below.

**Flat rate standing offer customers**

One class of customers whom we can confidently conclude are now on a better deal than they were prior to 1 July 2019 are those who were on flat rate standing offer contracts and were automatically transferred to the VDO.

The ESC estimated that the VDO would automatically apply to around 160,000 Victorian customers (130,000 households and 30,000 small businesses) from 1 July 2019.29 The vast majority of these customers will be better off under the VDO.30

**Non-flat tariff standing offer customers**

A VDO for customers on non-flat tariffs (including a two-rate (peak/off-peak) tariff, a time of use (TOU) tariff or a demand tariff) is scheduled to be introduced from 1 January 2020.31

Meanwhile, retailers continue to set the standing offer price for these variable rate tariffs.

However, we are aware that some retailers have reduced their non-flat tariff standing offers to a level similar to the VDO from 1 July 2019. For example, St Vincent de Paul’s Victorian Tariff Tracker found that: ‘…for standing offer customers on a two-rate tariff (peak/off-peak), AGL and Origin’s two-rate offers have decreased, on average, by -18% and -21% respectively, while Energy Australia’s standing offer has remained unchanged’.32

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29 Essential Services Commission, ‘Government accepts regulator’s advice on fair electricity price’, Media release, 30 May 2019

30 An estimated 330 customers who were previously receiving a 30 per cent rebate on their standing offer that was discontinued after 1 July 2019 would likely pay slightly more for their electricity after 1 July 2019.

31 Essential Services Commission 2019, Victorian Default Offer to apply from 1 January 202: Draft decision

**Active customers**

The VDO was designed to protect inactive customers from inflated prices, and it was intended that customers prepared to shop around would still be able to access lower priced offers.

Although the Panel has observed (see discussion at section 2.3.2) a noticeable narrowing in the range of market offers (or a reduction in price dispersion) since 1 July 2019, customers who shop around can still benefit from a range of flat rate tariffs below the level of the VDO. There has also been a decline in offers incorporating conditional discounts. As also highlighted in section 2.3.2, there are benefits that can arise from this if it results in greater pricing transparency.

Another concern raised by some stakeholders prior to the introduction of the VDO was that there could be adverse indirect effects on gas consumers if electricity prices were regulated and gas prices were not. Victoria has the highest prevalence of residential gas, and to be competitive on retail electricity a number of suppliers provide attractive offers to supply gas as well.\(^\text{33}\) The Panel has therefore monitored residential gas prices before and after 1 July 2019 and found this not to be the case.

**Other customers**

We are aware that some customers are likely to be on legacy contracts that have higher tariffs than those currently available in the market. In order to definitively identify how many customers are on these higher priced contracts, it would be necessary to have access to information on what prices customers have actually been paying both before and since the introduction of the VDO.

The Panel understands the ESC is in the process of collecting information to fill this gap, which will be critical to inform a fuller assessment of the impact of the VDO on consumers overall. Ahead of the ESC work, we can simply note that available evidence (which is slim) suggests this cohort of customers could be significant. Consumer groups have pointed to 2017 work by the AEMC which reported 47 per cent of customers had not switched in 5 years, yet for many of these customers the benefits of the deal that they had initially signed up to would have lapsed after 24 months or less.\(^\text{34}\) The Independent Review similarly noted that around two thirds of consumers could make large savings from switching and nearly a quarter could save at least $500 per year.\(^\text{35}\)

2.3.6 Have consumers who would benefit failed to access the VDO?

As noted in section 2.3.5, consumers on lapsed market offers could also be better off switching to the VDO. However, it is likely that customer inertia would mean that the uptake of the VDO by those customers that could benefit will be low.

The issue of customer inertia has been well recognised. The Independent Review spoke of the need for a fair price for consumers who cannot, or do not wish, to engage in the market.\(^\text{36}\) Consumer groups have also noted that switching is something that many households have demonstrated they are not willing to do and have called for complementary policy to ensure the VDO is ‘really a default offer’.\(^\text{37}\) The Panel notes that even switching rates do not always indicate engagement given they cannot distinguish between an active market choice and an incidental market choice, (for example, when a consumer moves house, which almost half of Victorians have done in the five years before the 2016 Census).\(^\text{38}\)

Customer inertia has been shown to persist even where there is an added financial incentive – as demonstrated by the relatively low take up of the Victorian Government’s offer of a $50 Power Saving Bonus to customers prepared to switch to lower priced offers.\(^\text{39}\)

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\(^{33}\) AEMC 2019, Retailer Energy Competition Review, p.44, 51

\(^{34}\) See for example Consumer Action Law Centre submission to the ESC dated 30 January 2019.

\(^{35}\) Thwaites, J, Faulkner, P & Mulder, T 2017, Independent Review into the Electricity & Gas Retail Markets in Victoria, p.22

\(^{36}\) Thwaites, J, Faulkner, P & Mulder, T 2017, Independent Review into the Electricity & Gas Retail Markets in Victoria, p.36- 38, p.53 - 55

\(^{37}\) Consumer Action Law Centre submission to the ESC VDO Issues Paper 12 Aug 2019 p.5.

\(^{38}\) Australian Bureau of Statistics 2017, 2016 Census

\(^{39}\) ABC News 2018, ‘ Victorians missing power savings because of ‘complicated’ comparison website: consumer groups’, 23 July
New regulations promoting greater pricing transparency and providing more timely prompts for customers to consider alternative offers could encourage more customers who would benefit from doing so to switch to the VDO. In particular, since 1 October 2019, retailers have been required to include information on electricity bills about how customers may access the VDO from their existing retailer. The benefit of this policy is that it places the information before a consumer at a time they are already engaged in some consideration of their energy bills, and does not require them to take the added step of switching provider in order to access a better deal.

It would be useful if the ESC’s information gathering work is also able to focus on movement in consumer contracts around the introduction of this further reform. This should provide insight as to the effectiveness of this new requirement and whether further initiatives should be considered.

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3. Comparing the VDO and DMO

3.1 Background

Prior to the introduction of both the VDO and the DMO, the Commonwealth Treasurer on 27 March 2017 commissioned the ACCC to undertake a public inquiry into the supply of retail electricity and the competitiveness of the retail prices in the National Electricity Market. The inquiry looked at the drivers of retail electricity prices over time, including factors at all levels of the supply chain that may affect price, and options to address price impacts on customers.\(^{41}\)

The ACCC’s final inquiry report, released on 11 July 2018, contained a number of recommendations to improve energy affordability across all segments of the energy market (i.e. wholesale, network, and retail).\(^{42}\)

In relation to pricing in the retail sector, the ACCC considered that a direct price intervention was required to counter retailers’ incentives to inflate standing offer prices and take advantage of consumers who are not engaged.\(^{43}\) In particular, ‘loyal’ customers on standing offers were paying well above market rates for their electricity. The ACCC on that basis recommended (recommendation 30), the abolition of the standing offer and replacing it with a lower-priced “default offer” based on the efficient cost of operating in the region, including a reasonable margin as well as customer acquisition and retention costs. The ACCC also noted that the lower-priced default tariff will have a proportionately greater benefit to small business customers, given the larger proportion of small business customers on standing offers.\(^{44}\)

New South Wales, South-east Queensland and South Australia subsequently reached agreement with the Australian Government to introduce a DMO which would set an annual price cap on standing offer contracts in all network distribution areas. The AER was tasked with determining DMO prices annually for each network distribution area and customer type.\(^{45}\)

Prior to the ACCC’s final inquiry report, the Independent Review had recommended the Victorian Government introduce a Basic Service Offer, which would be determined by the ESC and be based on the efficient cost to run a retail business.\(^{46}\) In its response to the Independent Review, the Victorian Government announced its intention to introduce its own Victorian Default Offer (VDO), with the ESC commissioned to advise on the initial VDO price.\(^{47}\)

On 1 July 2019, the same day that Victoria’s default offer came into effect, the DMO was introduced in New South Wales, South-east Queensland and South Australia.

3.2 Differences between the VDO and DMO

While both the VDO and the DMO aim to improve affordability for customers on standing offers who cannot, or do not wish to, engage in the market, there are important differences between the VDO and the DMO.

As the ACCC has noted, the DMO is intended to reduce the ‘loyalty tax’ paid by standing offer customers whilst still allowing sufficient scope for competition between retailers in setting their market offers. The ACCC consider competition to be the most important driver of lower prices and the new advertising requirements of the Electricity Retail Code are aimed at improving competition in the retail market. In contrast, the VDO is intended to provide standing offer customers in Victoria with universal access to a ‘fair’ price. Consistent with these objectives, the VDO is currently set at a level that is lower than the DMO.\(^{48}\)

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\(^{41}\) Australian Competition and Consumer Commission 2017, ACCC inquiry into retail electricity supply and pricing – Issues Paper, p.2

\(^{42}\) Australian Competition and Consumer Commission 2018, Restoring electricity affordability and Australia’s competitive advantage – Retail Electricity Pricing Inquiry (Final Report)

\(^{43}\) Australian Competition and Consumer Commission 2018, Restoring electricity affordability and Australia’s competitive advantage – Retail Electricity Pricing Inquiry (Final Report), p.249

\(^{44}\) Australian Competition and Consumer Commission 2018, Restoring electricity affordability and Australia’s competitive advantage – Retail Electricity Pricing Inquiry (Final Report), p.xiii

\(^{45}\) Australian Energy Regulator 2019, Affordability in retail energy markets, p.39


\(^{47}\) Victorian Government 2018, Fair Pricing in the Energy Market: Terms of Reference for the Essential Services Commission, December. Note that the VDO differs from the recommended Basic Service Offer in that it includes an allowance for ‘modest’ customer acquisition and retention costs.

\(^{48}\) Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 Report, p.3-4
There are also differences in complementary regulations to improve pricing transparency under the two schemes. For example, retailers in DMO jurisdictions are now subject to the requirement that they must clearly present how their standing offers and market offers compare to the DMO and must not present conditional discounts as their headline discount.\textsuperscript{49} In Victoria, retailers are now required to state how their discounted market offer compares to the estimated annual cost of the VDO and, since 1 October 2019, to provide ‘best offer’ information on bills.

As a result of these differences in policy intent and accompanying regulatory requirements, the impacts of the VDO and DMO are not strictly comparable. Differences in retail price trends observed across jurisdictions since their introduction will also be influenced by other factors, including differing wholesale and network costs in different jurisdictions.

Nevertheless, the simultaneous introduction of the VDO and the DMO provides a unique opportunity to compare the impacts of the two alternative approaches to addressing essentially similar policy concerns.

To obtain comparable point-in-time retail pricing information for the four jurisdictions, the Panel has drawn on the following sources:

- AER, (2019) \textit{Affordability in retail energy markets} - an annual report containing preliminary observations on changes in the price of electricity retail offers in DMO jurisdictions from October 2018, June 2019 and July 2019. The July 2019 dataset represents a snapshot of a point in time around three weeks after the introduction of DMO prices.
- St Vincent de Paul’s tariff tracking reports for various jurisdictions based on price movement shortly after the introduction of the VDO and DMO.\textsuperscript{50}

3.3 Initial impacts of the VDO and DMO

Based on the above sources of information, a number of observations can be made on the initial impacts of the VDO and the DMO. In summary:

- Common price trends since the introduction of the VDO and DMO have included:
  - reductions in higher priced market offers
  - reductions in the number of available offers
  - significant reductions in price dispersion (as measured by the difference between lowest and highest price offers), particularly for tier 1 retailers, and
  - an across-the-board shift away from conditional discounting (where customers must take particular actions, such as paying on time, in order to receive discounts).

Where the two schemes have differed, at least in their initial impacts, are:

- the magnitude of savings to standing offer customers has been significantly greater in Victoria, reflecting the lower default price setting,\textsuperscript{51} and
- the ACCC has observed that the reduction in the spread of prices in DMO jurisdictions (New South Wales, South-east Queensland and South Australia) has generally been driven by an increase in the cheapest market offers, while in Victoria this has been largely due to a decrease in the highest prices.\textsuperscript{52}

The latter observation suggests that the VDO may be placing greater downward pressure on overall price levels relative to the DMO. These overall observations are outlined in more detail below.

\textsuperscript{49} Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 Report, p.3
\textsuperscript{50} For example; St. Vincent de Paul Society 2019, Victorian Energy Prices: July 2019: An update report on the Victorian Tariff-Tracking Project
\textsuperscript{51} Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 Report, p.4
\textsuperscript{52} Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 Report, p.5
3.3.1 Standing offer prices reduced from 1 July 2019

A comparison of household electricity prices before and after the introduction of the VDO and the DMO show reductions in standing offer prices in all network distribution areas.

Both the ACCC and the AER report that the cap on standing offer prices imposed in DMO jurisdictions has caused retailers whose standing offer prices were above the DMO price (more than 90 per cent of retailers in most areas) to reduce their standing offers to the level of the DMO price or lower.53,54

In Victoria, all flat tariff standing offers were set at the level of the VDO from 1 July 2019.

As expected, the lower default price setting in Victoria is generating significantly larger savings on average household bills for customers formerly on standing offer contracts. Whereas the DMO is generating annual household savings of between $130 (NSW Ausgrid distribution zone) and $190 (SA Power Networks distribution zone), in Victoria the VDO is saving households formerly on standing offers between $310 (Citipower distribution zone) and $430 (AusNet distribution zone) annually.55

While retailers can set their standing offers at a level below the DMO, the ACCC’s recent analysis suggested that most retailers have set their standing offer prices to be at or just below the DMO.56

3.3.2 Highest priced market offers are mostly lower than in 2018

Both the DMO and the VDO have led to a fall in highest price retail electricity offers.

In DMO jurisdictions, the highest priced household market offers in most distribution areas were lower in July 2019 than in October 2018,57 with many retailers lowering their prices ahead of the DMO’s 1 July 2019 implementation date.58

In Victoria, the tier 1 retailers have reduced their highest priced market offers by between $50 and $421 per year from July 2019,59 while the highest priced offers available across tier 2 and tier 3 retailers remained largely stable.

3.3.3 There has been a notable reduction in price dispersion from tier 1 retailers

There has been a reduction in the spread of residential flat rate market offers available from the tier 1 retailers in both Victoria and the DMO jurisdictions since the introduction of the pricing reforms. In Victoria, the difference between the most expensive and cheapest flat tariff market offers from tier 1 retailers in the Jemena distribution zone was around $84 per year in October 2019, compared to around $511 per year prior to 1 July 2019.60

In DMO jurisdictions the spread of market offers from tier 1 retailers from 1 June 2019 to 12 July 2019 fell by around 40 to 60 per cent in New South Wales, by over 50 per cent in South-east Queensland and by 28 per cent in South Australia.61

The reduction in dispersion in DMO jurisdictions (New South Wales, South-east Queensland and South Australia) has been due to a combination of the removal of market offers above the DMO and an increase the lowest market offers, with tier 1 pricing converging to a narrow band around the default price settings.62

The ACCC has observed however that this reduction in the spread in DMO jurisdictions has generally been driven by rises in the prices of the cheapest market offers, while in Victoria this has been largely due to a fall in the highest prices.63

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53 Australian Energy Regulator 2019, Affordability in retail energy markets, p.40
54 Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 Report, p.4
55 Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 Report, p.4
56 Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 Report, p.4
57 Australian Energy Regulator 2019, Affordability in retail energy markets, p.41
59 This is based on data sourced from the Victorian Energy Compare website for households that use 4,000kWh per annum
60 These figures are based on a household that uses 4,000kWh per annum.
61 Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 Report, p.58
62 Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 Report, p.6
The Panel has similarly observed that the reduction in the spread of residential flat tariff market offers in Victoria (at least those available from the ‘tier 1’ retailers) has been mainly due to the removal of market offers that were above the VDO, with the cheapest offer available falling in price in some distribution zones and increasing in others.\(^{64}\) This suggests that the VDO may be placing stronger overall downward pressure on retail prices relative to the DMO.

### 3.3.4 There has been a noticeable shift away from conditional discounts since 1 July

There has also been a change in retailer discounting practices in both Victoria and DMO jurisdictions since 1 July 2019. There is now a reduced prevalence of conditional discounting practices. At the same time there has been an increase in guaranteed discounts.

According to the AER, the proportion of household market offers with conditional discounts fell from between 47 to 56 per cent of total offers, depending on the distribution zone, to between 13 to 25 per cent over the period from October 2018 to July 2019. Over the same period, guaranteed discounts increased in prevalence from between 11 and 15 per cent of offers in October 2018 to between 23 and 29 per cent of offers in July 2019.\(^{65}\)

The ACCC has similarly identified a shift away from the use of conditional discounts after 1 July 2019. It noted that more than 75 per cent of household flat tariff market offers in South Australia, New South Wales and South-east Queensland now have no conditional discounts, compared with, around 39 per cent of offers in New South Wales and around 40 to 50 per cent of offers in South Australia and South-east Queensland in July 2018.

In Victoria, the Panel has observed that while only 18 per cent of flat tariff market offers in the Jemena distribution zone did not include a discount in July 2018, by July 2019, the percentage of flat tariff market offers without a discount had increased to around 56 per cent.

There have also been reductions in the quantum of conditional discounts since 1 July 2019 across all jurisdictions. The ACCC has observed that advertised discounts prior to 1 July 2019 were occasionally as high as 40 per cent or more, but since 1 July 2019 have generally been less than 20 per cent.\(^{66}\) In Victoria, the Panel has observed that the average pay-on-time discount is now around 8 per cent, compared to an average discount of around 23 per cent in July 2018. However, as noted in section 2, whether this represents a net decrease in the discount in dollar terms on the consumer bill depends upon the underlying rate the discount is applied to.

New regulations are likely drivers of changed discounting behaviour in both VDO and DMO jurisdictions, including:

- in Victoria, retailers that advertise discounted offers are required to use the VDO as a ‘reference price’. Retailers need to state (in dollar or percentage terms) how the discounted offer compares to the estimated annual cost of the VDO,\(^{67}\) and
- in DMO jurisdictions, a prohibition on retailers promoting conditional discounts as their most prominent discount; and a requirement to show the annual cost of market offers as a percentage in relation to the DMO price, along with a reluctance to show offers as higher than the DMO price.\(^{68}\)

The AER has noted that other regulatory developments may also be influencing retailers’ approach to discounting. They include:

- an AEMC rule change that prohibits retailers offering discounts where customers would definitely be worse off under the undiscounted market offer than under the standing offer, and
- the AEMC’s recent rule change consultation to propose the level of conditional discounts be restricted to the ‘reasonable cost savings’ that a retailer expects to make if a customer satisfies the conditions of the discount.\(^{69}\)

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\(^{64}\) This is shown in Figure 2 of this report.

\(^{65}\) Australian Energy Regulator 2019, Affordability in retail energy markets, p.44

\(^{66}\) Australian Competition and Consumer Commission 2019, Inquiry into the National Electricity Market: August 2019 Report, p.9

\(^{67}\) Victorian Government Gazette, No. S 208 Thursday 30 May 2019, Order under section 13 of the Electricity Industry Act 2000: Order in Council, clause 15

\(^{68}\) Australian Energy Regulator 2019, Affordability in retail energy markets, p.43

\(^{69}\) Australian Energy Regulator 2019, Affordability in retail energy markets, p.44
4. Conclusions

The Panel’s ability to draw definitive conclusions as to whether the VDO is achieving the government’s policy objectives about the overall impact of the reform on Victorian consumers is constrained in part by limits on available information and the timeframe over which the VDO has now been in place. Nevertheless, the early signs are encouraging.

Based on publicly available information on initial changes to Victoria’s retail electricity market over the period 1 July to mid October 2019, the Panel has observed that:

- despite industry concerns that the VDO would become a ‘floor’ price, this has not occurred
- active customers are still able to benefit from a (narrower) range of lower priced offers
- there has been a trend away from conditional discounting
- fears the VDO would be set so low as to force a number of retailers to exit the market, threatening ongoing competition, have also waned - indeed there is evidence that new retailers remain interested in entering the market
- there are early signs that, relative to the DMO, the VDO may be exerting greater downward pressure on prices paid by all customers, not just those on standing offers, and
- a number of customers are saving as a result of the introduction of the VDO. New and forthcoming policy initiatives should also help raise awareness of the VDO and ESC information gathering will provide insight into what customers are actually paying.

It will be important to continue to monitor these impacts over the coming months. In the future, with information on actual customer bills before and after the change, a more comprehensive assessment of the overall costs and benefits of the reforms can be undertaken.
Appendix A  Retailers included in this analysis

In this report we have grouped individual retailers into ‘tiers’, with tier 1 comprising the largest retailers, tier 2 comprising the mid-size and tier 3 the smaller retailers.


Alinta Energy’s customer base of around 92,000 falls just below the 100,000 customer threshold used in the Independent Review, but we have included it within tier 2 due to its ownership of generation assets.

Tier 1 retailers

- AGL
- EnergyAustralia
- Origin Energy

Tier 2 retailers

- Lumo Energy
- Momentum Energy
- Red Energy
- Simply Energy
- Alinta Energy

Tier 3 retailers

- 1st Energy
- amaysim
- Click Energy
- Commander Power & Gas
- CovalU
- DC Power Co
- Diamond Energy Pty Ltd
- Dodo Power & Gas
- Elysian Energy
- Energy Locals
- Globird Energy
- Kogan Energy
- Next Business Energy Pty Ltd
- People Energy
- Powerclub
- Powerdirect
- Powershop Australia
- Sumo Energy
- Tango Energy Pty Ltd