

1<sup>st</sup> April 2019



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**To:** Essential Services Commission  
Level 37, 2 Lonsdale Street  
Melbourne, Victoria 3000

To Essential Services Commission (ESC)

**Re: Active Utilities Pty Ltd (AU) Submission to Victorian Default Offer (VDO) to apply from 1 July 2019 – draft advice**

Thank you for the opportunity to comment on the ESC's draft advice to the Victorian Government on the Victorian Default Offer.

Active Utilities is an Embedded Network service provider, operating mainly with customers located on the east coast of Australia. Our Embedded Network business comprises of consulting to Developers, Strata Managers and owners/managers of buildings for the setup and ongoing management of Embedded Networks. As part of this service we sometimes provide a billing management agency service to these entities to ensure that their end customers receive a similar service offering to normal network conditions and meet relevant legislative requirements of operating these networks.

Active Utilities agree and welcomes the intent of the VDO, though believes consideration should be given to the wholesale cost methodology used for the commencement of the VDO, as explained in further detail below.

Additionally, Active Utilities believe consideration should be given to the VDO, being the instrument used as a maximum price cap for selling electricity under an exemption as it impedes on embedded network customers benefits of gaining alternative good value market offers from embedded network operators. This is explored in further detail below.

Active Utilities have also provided some further discussion points and queries stemming from the draft determination.

If you require any further information in relation to this submission, please feel free to contact me.

Kind Regards,

A handwritten signature in black ink, appearing to read "Mick Dovile", enclosed in a light grey rectangular box.

Mick Dovile  
General Manager

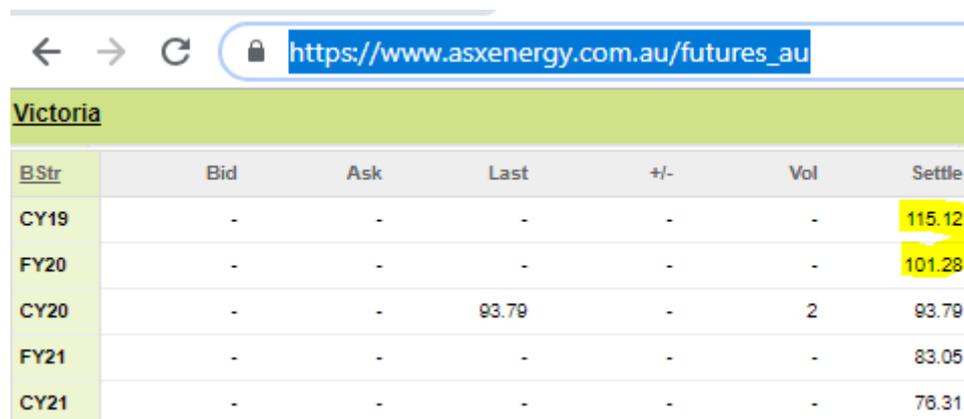
### Wholesale cost methodology for VDO commencement

Active Utilities agree with the implementation of the VDO being applied from 1 July 2019 to 30 December 2019, for a 6-month period to align the VDO with the timing of changes to network tariffs regulated by the AER. However, Active Utilities believe the ESC should review the methodology for the commencement of the VDO. We believe the methodology is imprecise due to retailers already locking in wholesale costs (and embedded networks having locked in energy rates) for CY19 which differ to FY20. This methodology disregards the fact that wholesale energy in Q1 2019 are materially higher than Q1 2020.

Active Utilities believe ESC's methodology to determine the level of future prices by using contract prices published by ASXEnergy for each quarter from 1 July 2019 to 30 June 2020, is not reflective of the actual costs that retailers and embedded networks will incur for the period 1 July 2019 to 31 December 2019.

Active Utilities believe that licensed retailers typically hedge their wholesale costs for Victoria on a calendar year basis. However, as highlighted in the graph below, the wholesale energy costs (as referenced by the futures market) in CY19 is materially higher than FY20 and retailers and embedded network operators are likely to incur the costs associated with CY19 and not FY20.

### ASXEnergy Futures Table<sup>1</sup>



The screenshot shows a web browser window with the URL [https://www.asxenergy.com.au/futures\\_au](https://www.asxenergy.com.au/futures_au). Below the browser window is a table titled "Victoria" with the following data:

BStr	Bid	Ask	Last	+/-	Vol	Settle
CY19	-	-	-	-	-	115.12
FY20	-	-	-	-	-	101.28
CY20	-	-	93.79	-	2	93.79
FY21	-	-	-	-	-	83.05
CY21	-	-	-	-	-	76.31

<sup>1</sup> Source [https://www.asxenergy.com.au/futures\\_au](https://www.asxenergy.com.au/futures_au) 2:14 PM 22/2/2019

## Terms of Reference and Methodology

### ***Embedded Network Costs***

Active Utilities notes that the VDO is based on a cost stack approach, relying on published data sources for estimating efficient wholesale, network, and environmental costs and ESC judgement for estimating retail operating costs, that is positioned on an efficient licensed retailer.

Active Utilities have identified that when using this methodology, Embedded Network Operator costs have not been considered.

Additionally, Active Utilities believe the cost stack approach fails to consider research and development where margins are directed towards the innovation, introduction, and improvement of products and processes; such as solar, renewable energy, integrated utilities systems and virtual power plants, to assist in sustaining lower costs to customers in the long term.

This breakdown of the cost stack methodology is further examined below:

Retail Operating Costs - The estimations and judgements that ESC has used for retail operating costs are based on an efficient licensed retailer. These estimations do not consider the actuality that embedded networks have materially different retail costs due to bespoke billing solutions for clients such as network only billing and white-labelling.

Loss factors - Loss factors referenced in the draft advice state MLF's, however embedded networks (and retailers) incur TLF's. Active Utilities seek clarification that TLF's are used instead of MLF's. This clarification is sought because if the wrong factor is applied, the losses will be incorrectly calculated.

Systematic risk – In the assessment of systematic risk, Active Utilities believes that ESC have not considered real risks raised by:

*Recent political uncertainty* – relating to energy policy in Australia which cannot be diversified. For example, in the recent history Australia has had:

- a carbon tax;
- a repeal of the carbon tax;
- the Finkel review;
- the setting of a renewable energy target;
- a reduction of the renewable energy target.
- no clear framework set for future energy policy, and:

*Embedded network regulatory changes – including:*

- embedded network exemption guidelines;
- power of Choice reforms;
- updating regulatory frameworks for embedded networks;
- electricity licensing exemptions; and
- the General Exemption Order.

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Active Utilities believe that all the above points are risks that are systematic and non-diversifiable; they need to be considered in the cost stack approach.

Furthermore, Active Utilities strongly agree with the ACCC's REPI final report of an average retail margin of 11 percent in Victoria<sup>2</sup> and believe the ESC should set the retail margin at the ACCC retail margin rate. We acknowledge ESC's counterargument of this margin but believe the points raised in the draft advice are based on possibilities and guesswork.

### ***Applying the VDO to embedded networks***

Active Utilities agree and welcomes the general intent of the VDO, though believes consideration should be given to the VDO, being the instrument used as a maximum price cap for selling electricity under an exemption<sup>3</sup>.

The original reason for applying a maximum price cap on embedded networks was due to a pricing monopoly that embedded network had. This has since been rectified by power of choice reforms and implementation of Embedded Network Managers. Active Utilities note there are currently further reforms to embedded network frameworks that will allow further provisions for efficient churning of customers to on-market retailers if requested.

If the VDO is implemented as a maximum price cap to embedded networks, this will prevent embedded networks from offering alternative good value for money contracts (that may cost more than the VDO). This will impede on embedded network customer's benefits, from those who are active on the market, from gaining alternative good value market offers and may force embedded network customers, who are otherwise happy with an embedded network operator, to go on-market to access these offers from licensed retailers. Active Utilities believe that embedded network operators should also be able to offer alternatives in the market above or below the proposed VDO, as the VDO currently sits below the median market offer in the majority of distribution zones.

Further consideration needs to be made, although outside the scope of this VDO draft advice, of removing a maximum price cap in its entirety as there is no longer a monopoly situation for embedded networks due to power of choice reforms and the implementation of ENM. These reforms allow embedded network customers to go on-market. Therefore, embedded network operators should be able to be competitive on a level playing field with licensed retailers.

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<sup>2</sup> ACCC, Retail Electricity Pricing Inquiry – Final Report, June 2018, p. 8.

<sup>3</sup> See clause 10 of the General Exemption Order 2017, November 2017, p. 6.

## Application of discounts based off the VDO

If discounts are to be based off the VDO, Active Utilities seeks further clarification on how a discount should be advertised and applied to a customer's invoice. Without a clear methodology Active Utilities sees there is a disconnect between the actual discount a customer receives and the advertised discount.

For clarification, we have provided 2 Market offer examples below, highlighting Active Utilities concerns:

### **Assumptions:**

- Reference Bill \$1,500
- Usage 4000kWh

### **Example 1**

A retailer advertises a 10% discount on the market offer where the consumption rate is 25c/kWh, and supply charge is \$1 /day.

- The estimated bill prior to the incentive will be 25c/kWh x 4000 kWh (usage) = 1000 + Supply Charge = \$1365 pa.
- The 10% discount must be based on the DMO = \$150
- $150/1365 = 11\%$ . *The retailer must provide the customer a 11% discount yet only advertise 10%.*

### **Example 2**

The retailer offers the customer a 25% guaranteed discount where the consumption rate is 31 c/kWh, and supply charge is \$1 /day.

- The estimated bill prior to the incentive will be 31c/kWh x 4000kWh (usage) = \$1240 pa. + Supply = \$1,605 pa.
- The above bill which is greater than the DMO but still not in breach of the DMO, provided the customer does not pay more than the DMO.
- The 25% discount must be based on the DMO = \$375 pa.
- $375/1605 = 23.4\%$  Therefore a retailer can advertise a 25% and the customer will receive a 23.4% discount.

Please see the table on the next page, which reflects the discounts based off the VDO examples provided above.



Discounts based off Reference Bills

Active Utilities Pty Ltd

Description	Usage c/kWh	Supply \$/Day	Usage kWh	Total bill Pre-Incentive (\$)	Advertised Discount off DMO (%)	Advertised Discount Value (%)	Customer Discount (%)
<b>Market offer 1</b>	25	1	4000	1,365	10%	150	11% <sup>4</sup>
<b>Market offer 2</b>	31	1	4000	1,605	25%	375	23% <sup>5</sup>
<b>VDO</b>			4000	1,500			

The above examples raise three major concerns:

1. Retailers who participate in predatory practices can gain the system;
2. Retailers who act in the customers best interest will be disincentivised to do so; and
3. Without major changes, current billing systems are unable to apply a discount to a client rate which is referenced a 'Reference Bill'.

In addition, all discount benchmarking (presumptions based on the concerns highlighted above) should be relevant to future offers only. This is to ensure that legacy offers can maintain their discounts and not become commercially unviable.

<sup>4</sup> Note that the advertised discount is 10% but the customer will actually receive a 11% discount in total. Hence retailers will under sell their offer and there will be major billing system issues.

<sup>5</sup> Note that the advertised discount is 25% but the customer will actually receive a 23% discount in total. Hence retailers will over sell their offer and there will be major billing system issues

### Time of Use (ToU) tariffs

Further to the Application of discounts based off the VDO (above), Active Utilities seeks further clarification on the below points:

- If discounts are to be based off the VDO as specified in the terms of reference, how will this assessment be made for discounts on ToU tariffs and structures that differ from:
  - Table 14 Proposed VDO for residential customers (GST inclusive)<sup>6</sup>, and;
  - Table 15 Proposed VDO for small business customers less than 40 MWh per year (GST inclusive)<sup>7</sup>.
- How does the ESC propose retailers and embedded network operators generate load profiles for ToU tariffs? If based on Manually Read Interval Meter (MRIM) data where would embedded network operators obtain this data from.

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<sup>6</sup> ESC, Victorian Default Offer to apply from 1 July 2019– Draft advice, March 2018, p. 73.

<sup>7</sup> ESC, Victorian Default Offer to apply from 1 July 2019– Draft advice, March 2018, p. 74.