Level 6, 17-19 Bridge Street
Sydney NSW 2000
www.amaysim.com.au

12 August 2019

To Ms Kate Symons
Commissioner and Acting Chair
Essential Services Commission (**Commission**)
Level 37, 2 Lonsdale Street
Melbourne Victoria 3000
retailenergyreview@esc.vic.gov.au

Dear Ms Symons

Submission on Victorian Default Offer to apply from 1 January 2020 - issues paper (Issues Paper)

This submission relates to the Victorian Default Offer to apply from 1 January 2020 - issues paper (**Issues Paper**) released by the Commission on 23 July 2019 in respect of the first VDO price determination to apply during the regulatory period from 1 January 2020 to 31 December 2020.

On 4 April 2019 and 22 May 2019, amaysim Australia Ltd (**amaysim**) made detailed submissions to the Commission on the Victorian Default Offer (**VDO**) implemented by the *Energy Legislation Amendment (Victorian Default Offer) Bill 2019* (**VDO Rules**) and the Commission's draft advice to the Victorian Government. In those submissions, we set out what we consider to be constructive suggestions (together with our reasons for them) for improvements to the VDO to make it fairer and more effective for consumers and industry. amaysim stands by those submissions.

In this submission, we have sought to provide specific comments on the Issues Paper and respond to the questions set out in that paper.

How does market volatility affect the cost to serve customers across the market?

As per our previous submissions, the cost-methodologies adopted by the VDO are heavily weighted to a substantial and mature gentailer profile. The reason is that gentailers are naturally hedged against market volatility, they generate significant profits from generation and do not need to solely rely on hedges or similar instruments to manage their wholesale costs. Asset-light retailers tend to be much smaller and are not well placed to accept the same wholesale market risk as tier one retailers because we are not vertically integrated.

amaysim (like most tier two retailers) has no generating assets and relies on generators and other counterparties to hedge (typically using load following hedges) our exposure to spot market volatility. This makes us a "price taker", with very limited scope to control our wholesale costs. This is an important point of difference between the majority of tier two retailers and tier one retailers (who are also gentailers) as it means we are more likely to have a larger wholesale cost than our vertically integrated competitors.

Ideally, the cost methodologies of the VDO would be re-sculpted to apply differently to tier one retailers and tier two retailers. However, we recognise that this would undermine the value of the VDO as a common reference point across the Victorian market. Accordingly, we submit that the new VDO cost stack must be weighted towards tier the cost stack of two retailers without generating assets to account for the different cost structures of these businesses and for this difference in wholesale market risk (and costs associated with managing that risk). We appreciate that this is a lowest common denominator approach. However, we submit it will promote better long-term outcomes for competition and consumers than forcing tier two retailers out of the market by using a wholesale cost stack which is not reflective of their actual costs.

Are the tariffs set out in table 1 and 2 on page 13 of the Issues Paper still the most appropriate tariffs to use in setting the VDO?

In regard to the network tariff categories set out in table 1, we note an error in the small business tariffs listed for Jemena. The appropriate small business tariffs are A200, F200 and T200.

Are there other issues – such as more complex tariff structures, that the Commission should consider in calculating network costs? How should these be resolved?

One additional issue to consider regarding calculating network costs, is that the Commission estimates the network losses relying on data available from AEMO for distribution loss factors and marginal loss factors. Distribution loss factors depends on the network and the type of line (either short sub-transmission or long sub-transmission).

Under the current VDO analysis, the Commission considers only the short sub-transmission line is relevant. Our understanding is that some customers are on long sub-transmission lines. Therefore, the VDO network losses are underestimated and should be weighted by the customer numbers on each type of line. This would add approximately $3.20 to the annual bill of a residential electricity customer.

Do the environmental scheme and regulatory costs listed on pages 14 and 15 cover all environmental and other costs?

We consider the listed costs on page 14 and 15 a complete summary of the costs.

However, our understanding is that most energy retailers acquire the majority of their LGCs via medium or long term bilateral arrangements and not via a market place.

Are there other more relevant sources or evidence that the Commission should consider?

We support the Commission's approach of requesting information on an individual basis regarding LGC (and other environmental) costs. We consider that this will help clarify the structural differences in environmental costs between tier one and tier two retailers.

We believe this is the best way to obtain an accurate view on the most recent costs incurred by different retailers.

Have any major changes occurred to retail operating costs since May 2019 when the Commission submitted its final advice to Government? If so, what is the nature and magnitude of these changes?

The following changes are material to retail operating costs and should be considered by the Commission's in setting the VDO price determination for the 2020 regulatory period:

- First, the retail operating costs analysed by the Commission in issuing the draft advice to Government in March 2019 were primarily based on the ACCC's Retail Electricity Pricing Inquiry (**REPI**) [1] analysis in respect of the 2017/18 financial year. This data is now old. Moreover, the purpose of this data was to analyse cost differences across different jurisdictions, between different size retailers and to identify the largest components of a retailers operating costs. It is inaccurate to rely on this data in order to calculate a retailers' operating costs for 2020.

[1] Australian Competition & Consumer Commission. Retail Electricity Pricing Inquiry, Final Report, July 2018.

- Second, the revision of retail operating costs set by the Commission when it submitted its final advice to the Government in May 2019 looked at the ICRC's 2017 decision. We submit that the cost stack for the 2020 price determination must be based on recent data as energy retailers have seen significant increases in operating costs over the last two years. These increases will not be captured in the REPI analysis or the ICRC 2017 decision, as the data contained in those instruments is old and, to a large extent, irrelevant given that it is based (in part) on a small regulated market. For example, since the research and publication of those instruments, energy retailers have seen significant cost increases in the area of bad debts.[2] A significant portion of a retailer's bad debt expense (and the continued escalation of bad debt), is largely a result of the write-off or lost revenue associated with "Occupier Accounts". This is a known industry issue. We therefore believe that other retailers are likely to have experienced this same increase and that it should be accounted for in the retail operating cost component of the cost stack for the 2020 price determination.
- Third, since May 2019, the industry has undergone significant regulatory change (both in Victoria and nationwide). As a result of these changes, retailers and other market participants have had to spend significant resources in system and process changes and training. In our case, the costs of preparing for the DMO are spread across customer bases in Queensland, New South Wales and South Australia. By contrast, given the unique regulatory requirements that were introduced in Victoria in 2019, we consider that an unfairly disproportionate amount of our national compliance expenditure for FY19 was attributable to our ongoing participation in the Victorian market. Specifically, amaysim had a dedicated team working on regulatory changes for at least six months and has also had to hire a full-time employee to provide ongoing support in this new regulatory environment. In addition, ombudsman costs across the jurisdictions in which we operate (including Victoria) have increased significantly this financial year. This is despite amaysim's volume of ombudsman matters having significantly decreased. The increased spend on people, systems upgrades and development, and the technical and operational adjustments to ensure compliance with the numerous 1 July 2019 changes, has led to significantly higher retail operating costs. We submit that increased regulation and compliance costs need to be factored into the VDO price determination of retailer operating costs.

Are there any new sources of data that the Commission should consider in order to estimate a modest allowance for customer acquisition and retention costs?

As per our earlier submissions, amaysim submit that more recent data than that contained in the REPI analysis (which finishes at 2017/18) needs to be considered when estimating an allowance for customer acquisition and retention costs.

Again, we support the Commission's approach in seeking information on an individual basis regarding retailer customer acquisition and retention costs and submit that the Commission must have regard to the structural differences between tier one and tier two retailers.

We support a process whereby confidential financial information is provided for the purpose of better informing the Commission on customer acquisition and retention costs. We believe this is the best way to obtain an accurate view on the most recent costs incurred by different retailers.

[2] This refers to the expense of bad and doubtful debt amaysim approximates per customer (figures provided to the Commission on a confidential basis). [redacted]

Are there other issues the Commission consider in determining retail operating margin?

How could the Commission resolve these issues in determining VDO tariffs for the first regulatory period (1 January 2020 to 31 December 2020)?

We submit that a larger allowance generally should be given to the retail operating margin to accurately reflect the significant increases in the 2018/19 retail operating costs. We have set out the material changes in costs since the ACCC's REPI analysis, above.

In addition to those changes, we encourage the Commission to adjust the retail operating margin in the VDO to align more closely with that of tier two retailers to enable us to compete equally with gentailers under this new regulatory framework. As we have stated above and in our earlier submissions, the cost-methodologies used by the VDO are heavily weighted to a substantial and mature gentailer profile. This cost-methodology bias does not consider the fact that smaller retailers often have to spend more money to acquire customers or invest more in customer service than large retailers or incumbents who have the full benefit of long-term investment in brand and services due to time-in-market and scale. The brands of incumbents are well known, and their marketing budgets have been, over the years, substantial. In contrast, smaller, lesser-known and newer market entrants have not had this benefit. The operating cost assumptions built into the VDO incorrectly assume an even playing field in this respect and effectively prevent new market entrants or any meaningful investment in marketing (or brand awareness) by them.

It is unreasonable to expect smaller retailers to operate on the same retail operating margin as large vertically-integrated incumbents who have more capital, who can benefit from wholesale markets and who are able to withstand the prolonged pressure of a low retail margin through their generation businesses. We accordingly submit that the cost methodologies of the VDO be reconsidered and re-sculpted to align more closely with the costs of the smaller and medium retailers who are "price takers" and unlikely to withstand the prolonged pressure of a low margin environment.

In what circumstances should the Commission consider, and on what basis should the Commission decide on, a proposed variation to a VDO price determination?

The intent behind the VDO was to safeguard the interests of "disengaged customers" (i.e. standing offer customers) by requiring retailers to offer those customers the VDO and setting a cap on its price. The VDO, together with the Best Offer rules, goes far beyond its original intent in that it has effectively become a retail plan which must be offered to all customers.

Under the current VDO Rules and "clear advice entitlement" rules, post 1 July 2019 we have seen a mass offering of the VDO by retailers to customers who are "active in the market". This has resulted in an overall reduction in customers moving between retailers. By way of example only, following the 1 July 2019 regulatory changes, Alinta Energy announced a 50% decrease in sales per day and Chief Executive Jeff Dimery is reported as saying this the result of introduction of the default market offer, which has narrowed the gap in which Alinta can offer discounts and therefore has reduced the incentive for customers to switch supplier.[3] Similarly, amaysim has experienced an overall reduction in sales since 1 July 2019.

These amendments effectively make the VDO another generally available plan and may ultimately lead to, as the ACCC have stated, more disengagement in the market as "*individual customers that were shopping around and benefiting from retail competition may disengage and end up paying a higher amount under a VDO*".[4]

[3] "Default offers hit growth at acquisitive Alinta" by Smith, A. Published in Financial Review on 5 August 2019 and available here: https://www.afr.com/companies/energy/default-offers-hit-growth-at-acquisitive-alinta-20190805-p52dv7

[4] ACCC submission to Victorian Default Offer to apply from 1 July 2019 - draft advice (ACCC Submission), page 2.

We encourage the Commission to revisit the ACCC's submission on the VDO, in which it warned that making the VDO another generally available plan may ultimately lead to more disengagement in the market as "*individual customers that were shopping around and benefiting from retail competition may disengage and end up paying a higher amount under a VDO*".[5] We are already experiencing this effect and we are only 6 weeks into the new regulatory environment.

We are concerned that the VDO, in its current state, is contrary to the Terms of Reference and needs immediate revision. We intend to write to the Victorian Government on this matter more generally.

Given that the VDO has essentially become a mass market product, amaysim submits that ongoing 6 monthly reviews of the VDO price determination should be adopted to allow for incremental changes. This is a preferable approach compared to annual reviews which will lead to structural distortions within the retail market.

Is there any new evidence that suggests another approach could be taken to allocating costs between dollars per day and per kilowatt hour charges?

As we have outlined above, we recommend a consultation process between the Commission and key stakeholders. We believe a practical and fair solution to the allocation of fixed and variable costs (and the entire VDO cost stack more broadly), is to adopt a process whereby individual retailer financial information is provided, on a confidential basis, for the purpose of better informing the Commission on the different retail operating costs incurred by different retailers.

We are pleased that the Commission is taking this step for the 2020 price determination.

Are there any other matters we should consider when allocating fixed and variable costs?

The VDO must include a specific allowance for the amount a retailer incurs in relation to capital expenditure and the most transparent way to do this would be via inclusion of an allowance for Depreciation and Amortisation. We would be happy to provide financial information that supports our historical capital expenditure spend and depreciation/amortisation expense.[6]

Are there any other issues the Commission should consider regarding the basis for the VDO compliant maximum annual bill?

amaysim does not consider either Approach 1 or Approach 2 provide a comparable option for its subscription products as both approaches require a retailer to rely on a model usage consumption profile based on a typical market offer tariff structure.

As we have stated above and in earlier submissions, amaysim's subscription plans (as with many other innovative and alternative offers) are extremely difficult to express in manner which is both compliant and clear, simple and customer-focussed manner given the rules are designed for typical post-paid consumption-based market offers. This is a fundamental issue as it runs the risk of disincentivising innovation.

To illustrate, it is impossible to accurately compare the "VDO compliant maximum annual bill" to a subscription customer's "annual bill" as the value of a subscription plan is a combination of a fair monthly price and that customer's rolled-over energy which is "banked" for future use. Here are more details:

- **confusing tariff structures vs same up-front price each month**: the "VDO compliant maximum annual bill" is intended to "*cover tariffs where usage charges vary at different times of the day, such as time of use or flexible tariffs*". amaysim's energy subscription plans are not constructed to charge customers on a typical usage and supply basis. Rather, customers pay

5 ACCC submission to Victorian Default Offer to apply from 1 July 2019 - draft advice (ACCC Submission), page 2.

6 This refers to the Depreciation/Amortisation expense in FY19 (figures provided to the Commission on a confidential basis). [redacted]

the same upfront subscription fee each month for an allocated usage allowance and are able to "top-up" (at the same rate) during that month if they exhaust their allocated kWh. If a customer does not use all of their allocated kWh, this usage is "banked" by the customer and rolls over, available to be used at a later time. We submit that, at a minimum, a retailer should have the discretion to attribute a reasonable value to stored or "banked" energy allowances provided it has a reasonable basis for doing so;

- **average usage profile vs flexible subscription allowances**: the assumed VDO usage profile is a fixed average annual estimate that does not align with our energy subscription plan usage allowances (which vary between 2,400kWh/year at a cost of $80/month and 5,280kWh/year at a cost of $160/month). Our medium sized plan costs $120 per month and includes 3,840kWh per year. Our energy subscription plans offer customers flexibility to move between plans with usage allowances suited to their usage profiles. Customers can monitor their usage behaviour through our real-time usage monitoring app service and top-up and rollover energy month to month. The "VDO compliant maximum annual bill" is based on a fixed average of estimated energy usage. This baseline does not align with our subscription energy plans and presents us with the challenge of providing customers helpful and accurate information which is also compliant; and
- **standard market offers vs innovative product constructs**: additional features of our energy subscription plans include bill predictability (due to our "same upfront monthly cost" for a fixed monthly amount of energy each month), real-time energy usage monitoring via our custom-made apps, and saved energy rollover features. These are valuable features which are hard to factor into a VDO cost stack yet they empower consumers to take control of how they use and pay for their energy.

We understand that the Commission recognises that subscription plans are not a product construct contemplated under the current regulatory framework. As such, the Commission has commented that it is separately considering whether the methodology in calculating a retailer's Best Offer should be adjusted to account for the inherent value of the feature set of subscription plans, particular energy rollover (or whether they should be excluded from the Best Offer message and clear entitlements advice altogether).[7] In our view, these same issues arise under the VDO Rules.

Subscription energy plans that allow customers to freely move between plans, monitor energy usage, rollover unused energy and leave at any time, are not the kind of product which the VDO reforms were intended to be the antidote. To that end, we submit that monthly subscription plans should be exempted from the VDO Rules and any rules flowing from the VDO Rules (or the rules and requirements should be adjusted to account for the inherent value and benefits which these innovative plans deliver to consumers). amaysim intends to write to the Government separately on this issue as we consider the current framework a blocker for retailers to introduce innovative, simple, and trusted products to the Australian market.

Through this exemption, we believe that subscription energy plans which introduce customer-centric innovative features and empower customers will shift the Victorian retail energy market away from confusing energy products, towards a simple, trusted and reasonable priced electricity option.

We intend to write to the Victorian Government separately in relation to this proposed exemption.

What are the key issues associated with setting prices applying to embedded networks?

amaysim has no comments in respect of embedded networks in this context.

****

[7] Essential Services Commission, Final Decision - Consequential amendments related to the Victorian Default Offer Final Decision, released on 13 June 2019, page 11.

As always, we would welcome the opportunity to discuss these matters and our recommendations with the Commission. Please contact our Chief Strategy Officer, Alexander Feldman or Chief Executive Officer, Peter O'Connell.

Yours faithfully

Alexander Feldman
Chief Strategy Officer & General Counsel