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Essential Services Commission
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Submitted by email: retailenergyreview@esc.vic.gov.au

Developing a Reference Price Methodology for Victoria's Energy Market

Thank you for the opportunity to provide a submission in response to development of a reference price methodology for Victoria's energy market.

Momentum Energy is a 100% Australian-owned and operated energy retailer. We pride ourselves on competitive and transparent pricing, innovation and outstanding customer service. We retail electricity in Victoria, New South Wales, South Australia, Queensland, the ACT, and on the Bass Strait Islands. We offer competitive rates to both residential and business customers along with a range of innovative energy products and services. We also retail natural gas to Victorian customers.

Momentum Energy is owned by Hydro Tasmania, Australia's largest producer of renewable energy.

Introduction

Momentum understands that the ESC has been provided with terms of reference by the Minister, the Hon. Robin Scott MP as a part of the Government's response to the Thwaites report. While the ESC is constrained by these terms of reference, we appreciate its obligations under the Essential Services Commission Act (the Act) to advocate the long term interests of Victorian consumers. We acknowledge that the ESC cannot abrogate its responsibility by failing to discharge its duties under the terms of reference, but that it is crucial it prominently articulates the potential impact that the proposed approach to reference price setting will have on the Victorian consumer.

It is vitally important that the ESC provide candid advice to government in light of the requirements of Section 8A of the Act which requires it to have regard to:

- efficiency in the industry and incentives for long term investment;
- the financial viability of the industry;
- the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries.

Momentum has informed the Victorian Government of its view that the imposition of a reference price does not necessarily deliver outcomes for consumers that are commensurate with its intent. A reference price which does not reflect that total cost of retailing energy will deliver further consumer suspicion in the industry and across Government as retailers will not be in a position to offer a product aligning to that reference price. Consumers will experience extremely diminished standards of service as costs are offloaded. Further cost reduction techniques may involve undertaking greater wholesale exposure increasing hedging risk and potentially placing complete business models under stress. This will deprive consumers of the disruptive and innovative influence that smaller retailers bring to the market and return greater concentration of customers to Tier 1 retailers contrary to Victorian Energy Minister The Hon. Lily D'ambrosios remarks at the CEDA

Energy Future event on 12 April 2018, that increased market concentration is not a desirable outcome.

As Momentum has outlined in its response to the Department on the Government's interim response, the idea that an efficient price can be determined in the current climate of uncertainty is not realistic. With the ACCC poised to release its final report by the end of June, and considerable work to be undertaken on the National Energy Guarantee, the extent to which a reference price is even necessary is unclear. The actual value of the wholesale market component of such a price is even more so. This said, we expect the ESC to develop a pricing methodology as per to terms of reference issued and provide the following comments to inform the setting of the reference price.

Cost Based Approach

Momentum supports a cost based approach to price setting however we caution that the Thwaites report, and the ESC in previous work have overstated the retail component of residential bills. The consultation paper cites net margins ranging from 9% whereas the ACCC in their Retail Pricing Inquiry Preliminary Report state that 9% is the Victorian average retail margin. We highlight that the ACCC figure is based upon data provided by retailers under enforceable notices and is consequently a robust and more accurate metric than any insight gained through the Thwaites review.

We understand that the only way that the ESC can accurately estimate retailer costs, is with input from retailers, and Momentum commits to providing as much assistance as possible in this regard. We expect that the ESC will adequately account for all costs, including those which retailers face as a consequence of peculiarities of the Victorian regulatory framework and policy decisions made by the current government. Having done so, we expect that the ESC will be forthright in presenting this information to Government so that these costs which are widely attributed retailer issues can be more correctly allocated as the higher costs of operating in the Victorian market.

Similarly, we expect that retailer feedback in relation to the costs of implementing the remaining suite of Thwaites reforms is considered. We support recommendations 3-11 and believe that they play will a role in helping ensure fairer outcomes for customers who are disadvantaged by current market practices, however changes to retailer processes and systems cannot be made without incurring costs which can only be recovered from consumers.

Wholesale

As the Commission is aware, significant movements in the wholesale market have driven the bulk of increases in the retail energy prices being felt by Victorians in the past 18 months. As retailers, particularly those who are not part of a vertically integrated gentailer model and have no influence over wholesale costs, it is of paramount importance that this component is correctly calculated. As outlined in our submission to the Thwaites review, we do not believe that a methodology exists which will accurately capture the energy costs faced by retailers as it is impossible to account for the different hedging strategies which reflect the range of risk profiles and growth or consolidation plans of each retailer. A particular challenge in the current environment is the uncertainty surrounding the NEG, ACCC report, Federal Government interventions and indeed the Victorian Government's response to the Thwaites review which all have the potential to fundamentally alter retailer strategies.

To allow for the range of costs faced by retailers, it is vital that a degree of conservatism be built into wholesale cost allowances as any analytical model is unlikely to reflect the reality of the market. The most sophisticated analytical model cannot replicate the reality of participating in a highly complex market and should not be assumed to provide a correct estimate of wholesale prices.

With this caveat in mind, we consider that the market based approach proposed by the ESC will give the best approximation of the wholesale market prices faced by retailers.

Retail Operating Costs

As outlined above, Momentum is concerned that retail operating costs be accurately reflected. We consider that these have been understated in past processes, and while underestimating costs may simply change the economics of a number of policy initiatives in these instances, in a process such as this one, which approximates price regulation, such underestimates may have unintended consequences for retailers. Momentum will provide advice on its own costs which will be based to a large degree on our technology platforms and the standard of service we provide.

We also stress that the ESC must give careful consideration to the practical application of the terms of reference. For example, a number of cost elements which would at first glance appear to be acquisition and retention costs may in fact include components which are crucial for the day to day servicing of existing customers. The consultation paper defines competition costs as the costs associated with acquiring new customers and retaining existing customers, and include general marketing, business development, promotions and sponsorships, costs of transferring customers to and from other retailers. While this definition is accurate, some of these costs cannot be stripped out without impacting service delivery.

The cost of transferring customers to and from other retailers, if calculated on a transactional basis is likely to be quite low, however the IT infrastructure and resourcing used to facilitate this is significant. Transfers is however just one function of this infrastructure which is also used for B2B transactions with AEMO and the network businesses on metering issues, faults, installation of photovoltaic systems and establishing new connections to greenfields sites. The associated costs must be included in the reference price to allow retailers to continue these functions.

Similarly, there may be a temptation to look at a retailer's marketing cost centre and simply deduct that from allowable costs however the marketing function is considerably broader than the acquisition and retention of customers. Mandatory communications and regulated collateral including customer notices and Price and Product Information Statements are developed by retailer marketing teams. Retailer websites, which are used by customers to find vital information and to self service are also often maintained by marketing teams.

Momentum is also curious about the cost of promotions and sponsorships being included as a competition cost. Victoria's five monopoly distribution networks, which constitute a considerable part of a retail cost structure, all engage in promotional and sponsorship activities ranging from partnerships with AFL clubs through to community grants despite facing no competitive pressure. This type of activity is an accepted part of good corporate behaviour and community engagement and is not an unnecessary burden on energy consumers as the Thwaites review would suggest. The fact that there is a suggestion that retailers should be prohibited from recovering the costs of these activities while the monopolistic elements of the supply chain are not reinforces our view that a reference price or BSO will do little to improve affordability and that retailers are unfairly targetted for the more fundamental issues which exist in the wholesale and network elements of the cost stack.

In conclusion, we again reiterate our appreciation that the ESC must act in accordance with the Terms of Reference issued by the Minister, but we urge you to advocate in the best interests of the Victorian consumer and provide advice to Government that, having regard to the matters outlined in

Section 8A, the reference price as described in the Thwaites Report and Terms of Reference is not in the long term interests of Victoria.

Additional information

If you require any further information with regard to these issues, please contact me on

[REDACTED]

Yours sincerely

Joe Kremzer
Regulatory Manager
Momentum Energy