

12 August 2019

Mr Marcus Crudden
Director, Price Monitoring and Regulation
Essential Services Commission
Level 37, 2 Lonsdale Street
MELBOURNE VIC 3000

Via email: retailenergyreview@esc.vic.gov.au

Dear Mr Crudden,

Re: Victorian Default Offer to apply from 1 January 2020 Issues Paper

Simply Energy welcomes the opportunity to provide feedback on the Essential Services Commission's (ESC) Issues paper on the Victorian Default Offer (VDO) to apply from 1 January 2020.

Simply Energy is a leading second-tier energy retailer with over 710,000 customer accounts across Victoria, New South Wales, South Australia, Queensland and Western Australia. As a leading second-tier retailer focused on continual growth and development, Simply Energy actively supports open market competition and energy affordability.

In setting annual VDO tariff rates to apply from 1 January 2020, it is imperative that the ESC takes into account the actual costs incurred by electricity retailers. Simply Energy notes that VDO prices are already constrained. As a result, any further reductions in retail operating margins are likely to have a disproportionate impact on smaller retailers, which cannot rely on large generation fleets to supplement their internal revenue streams. If the VDO is not set at an appropriate level, it will only reinforce the market position of the State's largest vertically-integrated 'gen-tailers', thereby reducing competitive tension and the options available to Victorian energy consumers. The ESC should, therefore, critically evaluate its proposed cost allocation methodology to ensure the VDO is cost-reflective for all electricity retailers, no matter their size or structure.

With this in mind, this submission focuses on ensuring that the ESC undertakes sufficient analysis to make itself aware of the actual costs incurred by electricity retailers. In undertaking this analysis, Simply Energy considers that it is crucial for the ESC to critically consider:

1. the wholesale and operating costs incurred by Victorian retailers; and
2. the potential cost exposures that may arise if the ESC does not set flexible VDO tariffs on a cost reflective basis.

Indeed, if wholesale and network costs are not adequately accounted for as part of the VDO cost stack, then there is a real possibility that resultant cross-subsidisations will create cost inefficiencies, which will lead to average Victorian energy consumers paying more in the long-term.

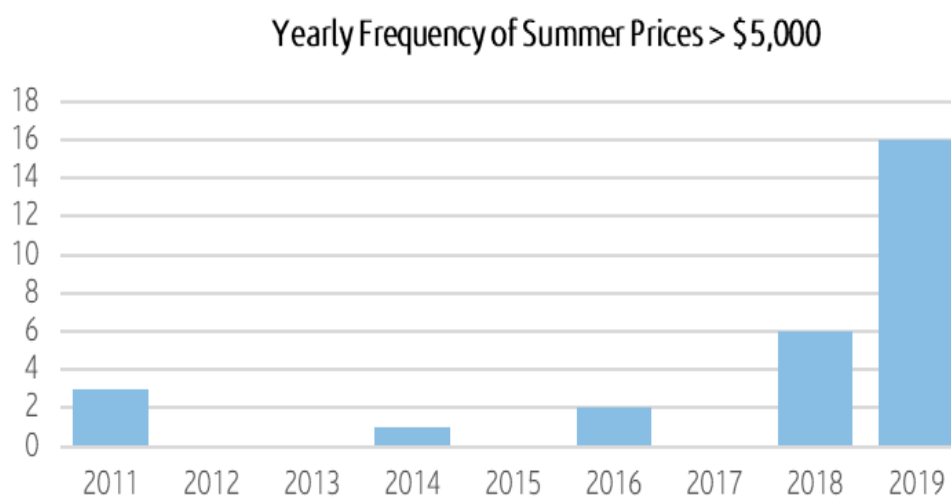
1 UNDERLYING RETAIL COSTS

1.1 Wholesale and external costs

Environmental, wholesale, network costs and incidental regulatory costs make up between 80 to 90 per cent of the VDO cost stack, depending on the network. These costs are outside the control of Simply Energy and most retailers, as they do not have significant generation portfolios. This means that retailers are primarily cost-takers. As a result, Simply Energy considers that it is imperative that each of these components reflect actual market outcomes.

Indeed, Simply Energy anticipates that wholesale electricity prices will remain high over the upcoming summer period. As observed in Figure 1, recent reductions in Victoria's baseload capacity means that the industry can reasonably expect to be exposed to continued high prices events in the first quarter of 2020. It should also be noted that the Australian Energy Market Operator is preparing for potential capacity constraints.

Figure 1: The number of half-hourly summer periods per year with prices greater than \$5,000 MW/h



Source: ENGIE internal analysis

With this in mind, Simply Energy encourages the ESC to undertake a comprehensive analysis of prevailing wholesale costs based on assumptions and modelling that can be readily scrutinised by industry stakeholders. It also needs to be kept in mind that hedging strategies can vary significantly between retailers. It is, therefore, important that the VDO provides sufficient margins to allow retailers to cover their exposure to unforeseen wholesale cost spikes like those experienced in the first quarter of 2019. In understanding the impacts of recent high price events, it is imperative that the ESC consults with retailers to understand the effects that increased wholesale volatility is having on the overall cost to serve.

1.2 Benchmarking and information gathering

1.2.1 Retailer and information gathering

Simply Energy understands that the ESC intends to request internal cost information from electricity retailers in order to better understand their underlying cost stacks. Simply Energy considers that this information will be critical in assisting the ESC to develop a cost stack that more accurately reflects the actual costs of providing retail services to Victorian electricity consumers. The ESC's heavy reliance on cost assumptions based only on publicly available data means that the VDO as set in July 2019 may not reflect the actual costs incurred by retailers operating efficiently in the Victorian market.

In saying that, Simply Energy understands that the ESC only intends to use data gathered from retailers as additional context rather than as the basis for setting its VDO cost stack. Simply Energy would, however, encourage the ESC to undertake its own analysis of the data provided by Victorian retailers. Simply Energy considers that third party information should only be used where assumptions need to be made, or where the actual cost data cannot be obtained. Given the ESC has had considerable time to refine its cost setting approach, and the VDO set from 1 January will be in place for 1 year, as opposed to 6 months for the current VDO, it is imperative that the ESC makes use of all relevant data at its disposal.

From Simply Energy's perspective, actual cost data will provide the ESC with a more holistic view of what constitutes a reasonably efficient cost stack for retailers doing business in Victoria. Indeed, each State and Territory has unique market characteristics meaning there is no such thing as a standard efficient cost across Australia.

Lastly, in terms of minimising the regulatory burden, Simply Energy recommends that the ESC works with the Australian Competition and Consumer Commission and the national energy institutions to develop a common set of reporting metrics. This will not only make it easier for retailers to extract required data, but will also ensure greater consistency in terms of comparing market data published by Australian energy regulators and policymakers.

2 FLEXIBLE TARIFF ARRANGEMENTS

2.1.1 VDO rates

From 1 January 2020, the ESC has been tasked with setting the annual maximum bill for customers on flat and controlled load tariffs, as well as customers on non-flat tariffs. Simply Energy supports the ESC continuing to set flat and controlled load tariffs using the same approach outlined in its final advice to government earlier this year.

Further, to maintain consistency and simplicity, Simply Energy is of the view that the ESC also should prescribe the VDO rates for time-of-use tariff customers. Time-of-use tariffs should be based on the representative annual consumption profiles set out in schedule 3 of the Order giving effect to the VDO. This will ensure the VDO remains a trusted, independently set price which is based on the maximum annual bill set for flat tariff customers.

2.1.2 Rationale for not capping time-of-use bills

Simply Energy acknowledges that its recommended approach for setting time-of-use tariffs differs from the proposal put forward in the Issues Paper. That said, Simply Energy would strongly recommend that the ESC does not use the flat tariff VDO rate as a basis for capping the prices incurred by consumers on time-of-use tariffs. Capping the prices of time-of-use customers in the manner proposed in the Issues Paper will distort cost-efficient price signals.

Given the requirement for retailers to provide best offer messages and clear advice, it is likely that some customers on market offer time-of-use tariffs would be advised to switch to a capped VDO as a means of limiting their exposure to peak electricity prices. While this would be a good financial outcome for customer using high volumes of electricity during peak periods, it could create market inefficiencies which will be disproportionately borne by other consumers.

It is likely that capped peak pricing will lead to an overall increase in peak demand, resulting in increased wholesale price spikes and higher network infrastructure costs. Consequently, disengaged consumers would likely be left paying for the cost premium created by savvy consumers who choose to exploit the regulated price cap for their personal gain. This would be an unacceptable position outcome for the Victorian electricity sector, as well as the Victorian Government and energy consumers more broadly.

2.1.3 Adjustments to account for network tariff rates

It also needs to be kept in mind that the VDO is not intended to be a cheapest offer in the market, but rather act as a safeguard for disengaged consumers. Its overarching objective is to 'provide a simple, trusted and reasonable price electricity option that safeguards customers unable or unwilling to engage in the electricity retail market.'

For this reason, the cost stack for the maximum annual bill should be adjusted to account for variances in the costs associated with the fact that not all VDO customers will be supplied based on a flat network tariff. Further, Simply Energy considers that a higher VDO tariff should be set for high intensity users with three-phase meters.

3 CONCLUDING REMARKS

In closing, Simply Energy looks forward to continuing to work actively with ESC in developing the VDO rates to apply from 1 January 2020.

Simply Energy welcomes further discussion in relation to this submission. To arrange a discussion or if you have any questions please contact Anthony O'Connell, Senior Regulatory and Compliance Officer, on, telephone, [REDACTED] [REDACTED] [REDACTED] or at [REDACTED]

Yours sincerely



James Barton
General Manager, Regulation