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11 April 2023

Essential Services Commission
Level 8, 570 Bourke St
Melbourne VIC 3000

Lodged via Engage Victoria

Dear Commissioners,

Re: Victorian Default Offer from 1 July 2023 – draft decision

Simply Energy welcomes the opportunity to provide feedback on the Essential Services Commission's (Commission) draft decision on the Victorian Default Offer (VDO) price determination to apply from 1 July 2023.

Simply Energy is a leading energy retailer across Victoria, New South Wales, South Australia, Queensland and Western Australia. Simply Energy is owned by the ENGIE Group, one of the largest independent power producers in the world and a global leader in the transition to a zero-carbon economy. As a leading retailer focused on continual growth and development, Simply Energy supports the development of effective regulation to facilitate competition and positive consumer outcomes in the market.

Simply Energy acknowledges that the proposed VDO price increases in the draft decision are significant and will be challenging for some small customers to afford at a time they are also facing broader cost-of-living pressure. The recent increases in wholesale costs have also created difficulties for the viability of energy retailers, as higher retail electricity prices will likely lead to more missed bills and add to bad debt costs carried by retailers at a time where margins are already at historically low levels.

Wholesale costs

Simply Energy reiterates its support for the Commission's proposed approach to estimating wholesale electricity costs and our view is that this approach is reflective of a prudent retailers' hedging strategy.

We also continue to support the proposal to set an end date of the 12-month window used to collect ASX energy prices and agree that this would improve transparency and consistency of annual VDO price determinations.

Retail operating costs and customer acquisition and retention costs

While we understand the Commission's reasoning for proposing to change its retail cost methodology to a benchmark based on retailers' cost data, we note that the Commission noted in the draft decision that they consider the current methodology is producing acceptable estimates of operating costs (noting that the current methodology results in a cost estimate within the range of retailers' actual costs). If the current methodology is still producing accurate estimates, we do not consider there is a compelling reason to change the retail cost methodology for the 2023-24 VDO.

We note that the Commission's proposal to rely on actual retail operating costs does not align with the recent findings of Claire Thomas and the Review of the VDO Order in Council. Specifically, the Review stated that '*a reliance on 'actual costs' to determine efficient costs can be problematic where there are significant differences in actual costs faced by retailers with vastly differing sizes and business models*.'[1] As will be discussed below, this issue is particularly pronounced for retail operating costs where the actual costs per customer are noticeably different between the big three retailers and the remainder of the market.

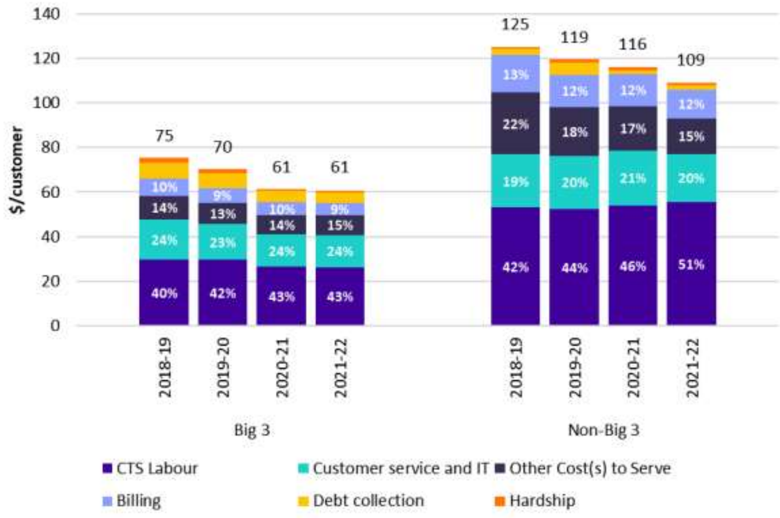
A customer-weighted average will not accurately estimate the average retail costs

As the Commission acknowledges in the draft decision, there are economies of scale in retailing electricity and larger retailers can operate at a lower operating cost per customer than smaller retailers and new entrants.

Our key concern with the Commission's proposed customer-weighted average is that this would inherently bias the estimate to align with the operating costs of the big three retailers. As highlighted in the Australian Competition and Consumer Commission's (ACCC) November 2022 report[2], the big three retailers have a significant operating cost advantage over all other retailers across the National Electricity Market. This same advantage is also visible in customer acquisition and retention costs.[3] Figure 4.7 of the ACCC's November 2022 report, included below, visually demonstrates the difference in retail operating costs per customer.

Figure 4.7: Big 3 retailers still have a large cost to serve advantage, despite the gap closing slightly

Average cost to serve per residential customer across the NEM by retailer tier, 2018–19 to 2021–22, real $2021–22, excluding GST



Source: ACCC analysis based on retailers' data.
Note: Data labels for small cost components have been omitted for readability. CTS = Cost to serve.

Source: Australian Competition and Consumer Commission 2022, Inquiry into the National Electricity Market – November 2022 Report, 8 December, p. 75 – Figure 4.7.

As all retailers are required to make the VDO available to their customers, not just the big three retailers, the use of a cost estimate that is reflective of larger retailers will likely make it more

[1] Department of Energy, Environment and Climate Action 2022, Review of the Victorian Default Offer Order in Council – Final Report, October 2022, p. 28.

[2] Australian Competition and Consumer Commission 2022, Inquiry into the National Electricity Market – November 2022 Report, 8 December, p. 75.

[3] Australian Competition and Consumer Commission 2022, Inquiry into the National Electricity Market – November 2022 Report, 8 December, p. 76.

challenging for smaller retailers to compete in the market and supply market contracts at or below the VDO price. In our view, a more appropriate estimate of the efficient retail operating costs across the market would be to use a benchmark based on a median or mean measurement.

Historical bad debt costs are not reflective of the costs to be incurred in 2023-24

Simply Energy expects that retailers face a risk of above-average bad debt costs in 2023-24. Victorian consumers experienced an increase in retail gas prices at the start of the year and are now facing an increase in retail electricity prices mid-year, at a time they are already experiencing cost-of-living pressures due to inflation and increases in housing costs. We expect that all these factors will likely result in a higher occurrence of missed bills and escalating energy debt for customers in 2023-24.

We do not consider that publicly available information on bad debt expenses in 2020-21 and 2021-22 will be reflective of the bad debt costs to be incurred in 2023-24. The Commission's approach to using an actual retail cost benchmark would mean that any significant increases in bad debt costs will not flow through into the VDO cost stack until two years after the period.

Market intervention costs

Simply Energy supports the Commission's approach to including market intervention costs in the VDO cost benchmarks, as these are significant costs that retailers will incur due to the Australian Energy Market Operator's intervention in the wholesale market in June 2022.

We also reiterate our support for the Commission to defer the recovery of any market intervention costs that are not known at the time of the VDO 2023-24 final decision. Based on the Commission's assessment of the magnitude of known intervention costs on a per customer basis, we do not expect that the unknown costs would be significant enough to justify re-opening the VDO price determination.

Retail operating margin

Simply Energy supports the Commission's proposal to maintain the retail operating margin at 5.7 per cent for the 2023-24 VDO. As with other cost stack items, we do not consider there is sufficient evidence to significantly depart from the current methodology at this stage. Although the average retailers' margin has been declining in recent years, we note that this has been partly due to the introduction of the VDO (and Default Market Offer) reducing the prices and margins related to customers on standing offer contracts.[4]

Concluding remarks

Simply Energy looks forward to working actively with the Commission to ensure that the 2023-24 VDO price determination accurately reflects forecast changes in the cost of supplying electricity retail customers in Victoria.

Simply Energy welcomes further discussion in relation to this submission. To arrange a discussion or if you have any questions please contact Matthew Giampiccolo, Senior Regulatory Adviser, at matthew.giampiccolo@simplyenergy.com.au.

Yours sincerely

[4] Australian Competition and Consumer Commission 2022, Inquiry into the National Electricity Market – November 2022 Report, 8 December, p. 73.

James Barton
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