Unit 10/613 Whitehorse Rd
Mitcham, VIC, 3132
29/1/19

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Essential Services Commission
Level 37/ 2 Lonsdale St
Melbourne, VIC, 3000

GloBird Energy submission on 'Electricity and gas retail markets review implementation 2018 (Victorian Default Offer)'

Dear Mr. Greasley and Essential Services Commission staff,

My name is John McCluskey, I am a Managing Director of GloBird Energy. GloBird is a licensed retailer supplying about 40,000 Victorian customers. I write to share GloBird's concerns on the ESC's Victorian Default Offer (VDO).

We strongly advise the government to consider underwriting the wholesale cost at the same quantity and load profile used in the Victorian Default Offer.

GloBird has provided some of the most competitive market contracts to Victorian customers since establishment. We appreciate the ESC's moves to consult industry to ensure the VDO works as intended. We are also glad to see the work done to date around how best to predict future energy cost based on historical data.

However, it is important to note that by implementing the VDO, the government is forcing all energy retailers to sell at a fixed price to any customer, while on the other hand leaving retailers exposed to wholesale energy cost fluctuations. Unlike fuel or gas, large amounts of electricity cannot easily be stored, even for a short time. Therefore, the wholesale cost is extremely volatile.

Many factors affect wholesale costs. Most are completely out of the retailer's control, the ESC's control, and even the Federal Government's control. These include supply & demand, weather events like drought or lack of wind, human made crisis, or natural disasters including bush fire.

Examples are the closure of Hazelwood in 2017 which saw the wholesale price jump by over 100% in a few weeks, and the drought in NSW impacting hydro generation in the third quarter of 2018. Higher gas prices and unreliable coal plants caused the future & spot market to rally by more than 20% in just a few weeks. A final example is a retailer's SREC/LGC liability. It is set in April each year, but it is applied retrospectively from January onwards. Estimating the cost of RECS 6 months in advance is risky.

The point is that forecasting energy events is problematic at best and impossible at worst. Errors are easy, and the ramifications are enormous. Retailers must estimate and forecast these factors well into the future, but account for them in their business now. In the 20-year history of the NEM, we have seen several energy retailers go under due to their failure to manage wholesale costs.

Before the VDO, a prudent retailer could, if necessary, adjust its market contract prices in reaction to the latest wholesale market conditions, and lock in the cost for the duration of the contract with forward hedging agreements. A retailer would also normally set their default price (standing offer) much higher to allow for any unpredictable events including government policy changes or major loss of supply, so that the business would not be exposed.

With the implementation of VDO, retailers will have to accept and sell at the price defined by the government. If the forward wholesale cost was estimated incorrectly, the retailer may have to sell power at a price that is lower than their input price.

When a retailer takes a position in the futures market to hedge exposure against volatility, they do so based on how many customers they have at that time. If they acquire new customers later, they will look at the latest wholesale market, and take out a new futures position based on the latest wholesale price, and then set their retail price for new customers accordingly.

Even if the price set in the VDO was set at a fair and reasonable level at the start of the year, this doesn't mean the wholesale market will stay at that price. It is not a static input cost. A prudent energy retailer may be able to hedge its supply for its current customers when the price was originally set, but market conditions change, and unpredictable events can push the wholesale cost higher. If the retailer is obliged to sell to a new customer at a fixed price, they would have to take out a hedge position at whatever the available wholesale price is at that time (something they have no control over), however they will not have the freedom of setting the retail price accordingly.

The compulsory sale at a fixed price, combined with the unpredictable nature of the market and unknown number of new customers to join the business could easily destroy a retailer. This would reduce competition, as well as any investor's confidence in the energy industry. Before introducing a circumstance where this could foreseeably happen, we'd advise another way.

We strongly advise the government to underwrite the wholesale cost at the same quantity and load profile used in the Victorian Default Offer.

This would give the government the lower default offer that it seeks. It would also mean that a retailer will at least have a fall back of being able to buy at a sustainable price in line with the price it is being forced to sell at. The low-cost retailers couldn't be wiped out by unexpected events.

GloBird appreciates the ESC's consultation on the VDO and wants a more liquid and competitive market as a result. Given our experience as a nimble low-cost retailer, it is vital that any changes are made with full regard given to the retailers who are already delivering low-cost energy.

If the VDO were to result in a situation where a retailer was forced to sell at a price that is lower than their supply price, then the smaller players would die first. The largest most powerful retailers would survive until the VDO became unviable. This would leave the market with a small number of powerful players with little or no competition. The government and consumers can easily be held ransom.

I'm available to discuss the idea of an underwritten default offer at the details below.

Regards

John McCluskey / Managing Director
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GloBird Energy 13 3456
10/613 Whitehorse Rd, Mitcham, VIC 3132
www.globirdenergy.com.au