

ACTIVE

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Submission: Victorian Default Offer price review 2020

12 August 2019

Active Utilities Pty Ltd

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12th August 2019

To: Price Monitoring and Regulation
Essential Services Commission
Level 27, 2 Lonsdale Street
Melbourne, Victoria 3000

To Essential Services Commission (ESC)

Re: Submission to Victorian Default Offer – issues paper

Thank you for the opportunity to comment on the ESC's Victorian Default Offer price review 2020: Issues Paper.

Active understands that the ESC is not proposing to formulate a maximum price for embedded networks through this VDO price determination process, but as encouraged, Active are providing views on:

1. How the VDO price review 2020 does not correlate in formulating a maximum price in embedded networks; and
2. A proposed methodology basis to assist the ESC in formulating a maximum price rule for embedded networks.

Active have previously submitted a "Maximum Pricing Rule for Embedded Networks" to the ESC on the 17th July 2019. Active have included this submission as part of this paper response as "**Attachment 1**". This attachment should be read in conjunction with this paper response, as the two submissions complement each other.

In this submission, Active have also highlighted the complex tariff structures, including ToU's, where we believe the principles will not interact successfully with an embedded network methodology.

Lastly, Active reiterate our belief that consideration should be given to the continuation of a maximum price cap being applied to Embedded Networks as it impedes on an embedded network customer benefit of gaining alternative good value market offers from Embedded Network Operators. This is explored in further detail in the "Maximum Pricing Rule for Embedded Networks" submission but understand that the consideration of removing a maximum price cap from Embedded Networks may be outside the scope of this review.

If you require any further information in relation to this submission, please feel free to contact me.

Kind Regards,



Kyle Johnson

Legal, Risk & Compliance Manager

Complex Tariff structures

Active believe complex tariff structures will not align to a maximum price rule methodology for embedded networks due to the complex nature involved. This is due to:

- ToU's have different network costs and will result in costs not being recovered;
- The proposed methodology to apply for the VDO will mean that all off peak rates will likely increase closer to the peak rate, hence customers who optimise their off-peak usage will be disadvantaged; and
- The true-up method proposed in the event that customers pay more than the maximum bill will not be possible to implement due to increased operational costs.

Therefore, based on the above, Active recommends an alternative methodology for ToU's. This alternative methodology requires the ESC to set an average price and usage for each ½ hour period interval per distribution zone. This method ensures that tariff structures would meet mass market pricing normalities and not include operational expenses.

Lastly, Active believes ToU profiles with demand should be excluded in its entirety from an embedded network maximum price methodology due to customer size and the variability of demand.

Operating Costs

Active expect that the ESC will need to use an entirely new set of estimations and judgements to calculate the retail operating costs of an efficient exempt seller. Active believe that the current methodology, used to calculate retail operating costs in the VDO, are based on an efficient licenced retailer and do not consider the actuality that Embedded Networks have materially different retail costs due to bespoke billing solutions for clients and a smaller market.

In Attachment 1, Active have gone into more detail on describing how the operating costs of an embedded network differ from a retailer and have proposed a methodology for calculating operating costs for embedded networks.

Changes in Regulation

Active understand that price determinations can be varied for a range of reasons. However, Active believe that any changes in regulation that affect an exempt seller needs to be applied and passed through at the margin in a VDO and maximum price cap rule.

For example, the Maximum Price cap should be set, if any price determinations are varied, these variations should be reflected in the cost stack as a pass-through provision and a margin applied in addition to this cost stack variance.

Attachment 1: ESC Submission – Maximum Pricing Rule for Embedded Networks

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17th July 2019

To: Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne, Victoria 3000

To Essential Services Commission (ESC)

Re: Active Utilities Pty Ltd (Active) Submission to the new Maximum Pricing Rule to apply by 1 July 2020

Thank you for the opportunity to comment on the Victorian Government's request for the ESC to develop a new maximum pricing rule, as provided for in clause 10 and new clause 25A of the General Exemption Order, by 1 July 2020.

Active understand this request stems from the Victorian Government's decision to not apply the Victorian Default Offer (VDO) to exempt persons selling electricity in Embedded Networks as the new maximum rule. Therefore, the development of a new maximum pricing methodology under clause 10 and new clause 25A of the General Exemption Order, is a priority for the ESC.

Active believe consideration should be given to the continuation of a maximum price cap being applied to Embedded Networks as it impedes on embedded network customers benefits of gaining alternative good value market offers from Embedded Network Operators. This is explored in further detail in this submission.

Active understand that the consideration of removing a maximum price cap from Embedded Networks may be outside the scope of this work program, therefore, have also provided some further discussion points and methodology that should be considered by the ESC in the event that the maximum pricing cap to exempt sellers is not removed.

As previously noted to the ESC (See Appendix 1), Active have offered stakeholder assistance in ESC's development of the new maximum pricing rule for Embedded Networks in which ESC has advised that Active will be included on the work program.

Active look forward to working closely with the ESC in relation to the maximum pricing rule work program. If you require any further information in relation to this submission, please feel free to contact me.

Kind Regards,



Kyle Johnson
Risk & Compliance Manager

Removal of Maximum Price Cap to exempt sellers

Active understand the general intent of the maximum price cap, though believes serious consideration should be given to the abolishment of the maximum price cap for Embedded Networks.

The original reason for applying a maximum price cap to Embedded Networks was due to a pricing monopoly that Embedded Networks had. This has since been rectified by 'Power of Choice' reforms and the implementation of Embedded Network Managers. Active also note that there are currently further reforms to embedded network frameworks that will allow further provisions for efficient churning of customers to on-market retailers if requested.

Active believe in order to ensure an even playing field that will ensure effective competition, the maximum pricing cap clause for Embedded Networks should be abolished and a methodology similar to the Victorian Default Offer should be applied to Embedded Networks where market offers could exceed the reference price.

If a maximum price cap continues for Embedded Networks, this has the potential to be disadvantageous to consumers as it impedes Embedded Network Operators from offering alternative good value for money contracts and/or bundled services that will block embedded network customer's benefits and could cause further costs to the end consumer.

Active implore the ESC to strongly consider removing the maximum price cap in its entirety and implementing a similar based VDO (utilising the below methodology) for Embedded Networks. This is due to Embedded Networks no longer holding a monopoly situation because of the power of choice reforms and the implementation of the ENM role. These reforms allow embedded network customers to go on-market if they so choose. By removing the maximum price cap in its entirety, the ESC is recognising that Embedded Network Operators should be allowed to be competitive on a level playing field with licenced retailers where the end consumer should not be discriminated against for residing in an Embedded Network.

Maximum Price Cap Methodology

Active feel, that if a maximum price cap (or a default offer similar to the VDO) is to be developed for Embedded Networks, that the cost stack methodology applied to the recent VDO is an ideal beginning base in order to develop a maximum price cap for Embedded Networks.

However, Active maintains some variances need to be considered when applying a similar cost stack methodology to Embedded Networks, as in Active's experience, efficient Embedded Network Operator costs are materially different from an efficient licenced retailer. These variances are further explained below:

Wholesale Costs

Active agree that the following costs should be used for the maximum price cap methodology:

- **Future Prices** – as they are publicly available and transparent; and
- **MRIM data** – although the data is not 100% comparable with customer profiles, it indicates a high level of correlation to an EN usage profile and is a public transparent data set.

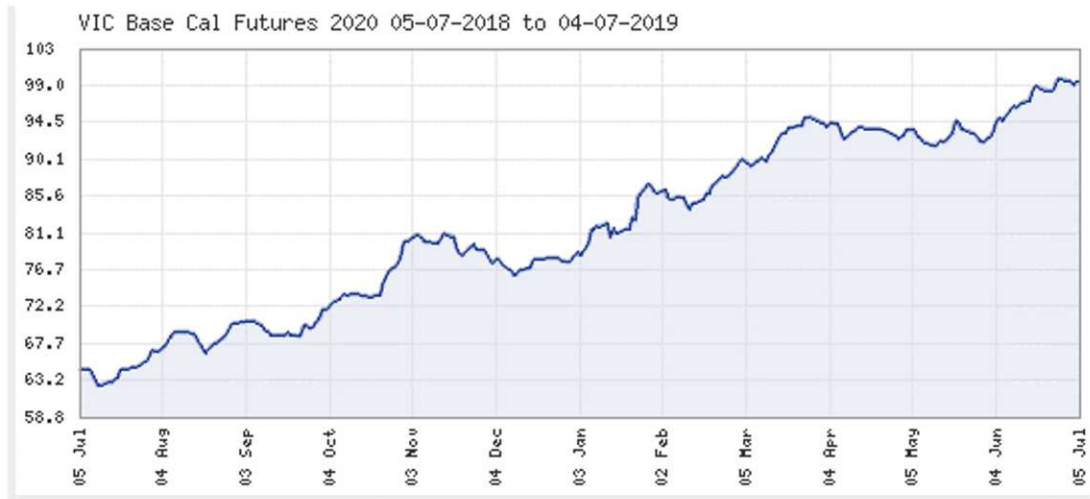
However, Active believes consideration should be given to the following wholesale cost methodology for Embedded Networks:

Reference Periods for Future Prices

The future prices used for the relevant period should better reflect actual costs incurred. The actual costs incurred could be ascertained by utilising a 30-day average price for a given reference period instead of using an average twelve (12) month average. Active also think that the 30-day average should be set 3 months prior to the effective date. The 30-day average price will allow exempt sellers to align their contracting to the costs expected.

Active have provided the following graphs or tables below to further illustrate the points of difference between using an average twelve (12) month average and using a 30-day average:

Difference between a 30 day and Annual average price*¹



Source:

<https://www.asxenergy.com.au/>

Table 1: 30 Day Avg Price

Month	Price*	Mth avg Price*	Price* difference over mth
Jul 18	62.3		
Aug	67.7	65	5.4
Sep	70	68.85	2.3
Oct	72.2	71.1	2.2
Nov	81.1	76.65	8.9
Dec	76.7	78.9	-4.4
Jan 19	77	76.85	0.3
Feb	85.6	81.3	8.6
Mar	90.1	87.85	4.5
Apr	94.5	92.3	4.4
May	89	91.75	-5.5
Jun	94.5	91.75	5.5
Jul	99	96.75	4.5

Table 2: Annual Avg Price

Annual avg Price*	Price* difference (Annually)
81.52	36.7

*Price = \$ per MWh

As you can see from the above, if using an annual twelve (12) month average, the price equals \$81.52 MWh with a price difference of \$36.7 per MWh over the twelve months. This is a significant difference from the 30-day average over an annual period which is \$3.05 per MWh.

¹ Graph figures are estimates based off ASX Energy VIC Base Cal Futures.

By using an annual average, it makes it extremely difficult for Embedded Network Operators to factor in the wholesale costs where using a 30-day average removes the uncertainty of future prices over the year.

Volatility Adjustment

Active agree with the Volatility Adjustment calculation used in the VDO methodology, but also believe that the volatility adjustment calculation must also form part of the wholesale energy costs for exempt sellers. The reasoning for including this in the volatility adjustment is due to the fact that exempt sellers do not perform any hedging activities as exempt sellers purchase electricity from a licenced retailer. Exempt sellers are also not the FRMP on the gate meter/s for the sites they manage and/or operate. Therefore, the licenced retailers pass on all prudential and / or credit costs with an added margin.

Retail Margin application

The retail margin of 5.7% (that is applied to the VDO Methodology) is an agreed upon reasonable estimate for exempt sellers. However, Active believes the retail margin of 5.7% should be applied to the sum of all components in an exempt seller's wholesale energy cost, including the volatility allowance.

Network Costs

Active would like to highlight that Network Costs incurred by an exempt seller are different than a standard retail or small business. Exempt sellers also incur demand costs which can materially change the profitability of an Embedded Network.

Active also maintain that some distributors have unfavourable tariffs on Embedded Networks (as demonstrated in further detail below).

However, Active proposes that the Network Tariff Code allocation, specified in the VDO does not change, as long as the unfavourable tariff treatment for Embedded Networks are removed.

Active presume, excluding the unfavourable tariffs imposed by some distributors, that the total network costs calculated by the ESC in relation to the VDO are a reasonable estimate for an Embedded Network.

Unfavourable Distributor Tariffs

As mentioned above, Active maintain that some distributors have unfavourable treatment for Embedded Networks. To further demonstrate this, Active have provided examples of Jemena Electricity Networks (Vic) Ltd – Network Tariffs for 2019 Calendar year with further details on how it affects Active, as an Embedded Network. These details are located on the next page.

Jemena Electricity Networks (Vic) Ltd – Network Tariffs for 2019 Calendar year

A30E	LV_{EN} Annual Consumption ≤ 0.8 GWh		
Only available to embedded network customers consuming ≤ 0.8 GWh pa			
<i>Peak: 7 AM to 11 PM AEST "Mon - Fri" ; Off peak all other times</i>			
- Standing charge	\$/customer pa		\$2,299.068
- Peak Unit rate	¢/kWh		4.286
- Off Peak Unit rate	¢/kWh		1.779
- Demand rate	\$/kVA pa		\$110.449
Minimum Chargeable Demand	120 kVA		
A320	LV 0.8⁺ - 2.2 GWh		
Only available to non-embedded network customers consuming > 0.8 GWh pa BUT ≤ 2.2 GWh pa			
<i>Peak: 7 AM to 11 PM AEST "Mon - Fri" ; Off peak all other times</i>			
- Standing charge	\$/customer pa		\$4,049.215
- Peak Unit rate	¢/kWh		3.806
- Off Peak Unit rate	¢/kWh		1.774
- Demand rate	\$/kVA pa		\$91.141
Minimum Chargeable Demand	250 kVA		
A32E	LV_{EN} 0.8⁺ - 2.2 GWh		
Only available to embedded network customers consuming > 0.8 GWh pa BUT ≤ 2.2 GWh pa			
<i>Peak: 7 AM to 11 PM AEST "Mon - Fri" ; Off peak all other times</i>			
- Standing charge	\$/customer pa		\$4,049.215
- Peak Unit rate	¢/kWh		3.658
- Off Peak Unit rate	¢/kWh		1.774
- Demand rate	\$/kVA pa		\$100.614
Minimum Chargeable Demand	250 kVA		

Source: <https://jemena.com.au/getattachment/8e2416a1-460c-4504-9bfd-a94b69a195a3/2019-Tariff-Schedule.aspx>

As demonstrated in the picture above, Jemena (distributor) tariff A30E is the base tariff that all Embedded Networks are placed on. This treatment by the distributor means there is a higher level of fixed costs for Embedded Networks. For example, \$15k per annum which could make small Embedded Networks operate at a high loss.

Furthermore, Jemena exclude customers who are an embedded network customer from various rates that would otherwise be applicable to them if they were not part of an Embedded Network. Active feels this discriminates against the individual end consumer and places them at a disadvantage.

Operating Costs

Market Share

Exempt sellers operate in a market much smaller than a licenced retailer. Therefore, Embedded Networks have a lower customer base to amortise their costs over.

In addition, given the additional services that efficient exempt sellers may provide (electricity, white labelling and other related services), usually on a singular bill, are deemed as bespoke and cannot be outsourced to more 'efficient' billing providers. Yet, in Active's experience, exempt sellers predominantly use the same billing systems as licenced retailers.

Therefore, Active considers, that the operating costs allowed in the VDO methodology will be too low in the maximum price cap methodology for an efficient exempt seller. Active have provided figures (below) to reflect a more efficient cost of an exempt seller.

Retail Operating Costs

Active expect that the ESC will need to use an entirely new set of estimations and judgements to calculate the retail operating costs of an efficient exempt seller. Active believe that the current methodology used to calculate retail operating costs in the VDO are based on an efficient licenced retailer and do not consider the actuality that Embedded Networks have materially different retail costs due to bespoke billing solutions for clients as detailed above.

Active feel the operating costs calculated in the VDO methodology are too low for an efficient exempt seller. Active have calculated a realistic efficient 'cost to serve' of [REDACTED] per meter based on data that aligns to our cost breakdown. Active feel this 'cost to serve' is better reflective of an exempt seller. To further assist the ESC, Active are happy to share our data with ESC on a confidential basis.

Active Utilities 'cost to serve' breakdown

Financial breakdown title

- [REDACTED] - Administrative
- [REDACTED] - General
- [REDACTED] - Technology
- [REDACTED] - Travel and Entertainment
- [REDACTED] - Occupancy
- [REDACTED] - Employment Expenses

Average 'Cost to Serve'

[REDACTED] per meter

Systematic Risk

In the assessment of systematic risk, Active feels the ESC need to also consider real risks raised by recent political uncertainty – relating to energy policy in Australia which cannot be diversified. For example, in the recent history Australia has had:

- a carbon tax;
- a repeal of the carbon tax;
- the Finkel review;
- the setting of a renewable energy target;
- a reduction of the renewable energy target;
- no clear framework set for future energy policy; and
- Embedded Network regulatory changes – including:
 - embedded network exemption guidelines;
 - power of Choice reforms;
 - updating regulatory frameworks for Embedded Networks;
 - electricity licensing exemptions; and
 - the General Exemption Order.

Active believe that all the above points are risks that are systematic and non-diversifiable that need to be considered in the cost stack approach.

Appendices

Appendix 1: Active Utilities – offering of stakeholder assistance

Active Utilities Pty Ltd
ABN 43 518 767 917
40 English Street, Essendon Fields, VIC 3041
T: 1300 567 623
activeutilities.com.au



25th June 2019

To: C. Stuart-Walker & J. Tasker
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne, Victoria 3000

To Chris Stuart-Walker & Jordan Tasker

Re: Offering of stakeholder assistance in development of new maximum pricing rule for embedded networks.

Thank you for the email, dated 30th May 2019, providing further information on the Victorian Default Offer (VDO) and the decision made by the Victorian Government on not applying the VDO to exempt persons selling electricity in embedded networks as the new maximum rule at this time.

We understand that the Essential Services Commission (ESC) has been asked to develop a new maximum pricing rule, as provided for in clause 10 and the new clause 25A of the General Exemption Order, by 1 July 2020.

Active Utilities, as an Embedded Network Operator, would like to assist the ESC as a relevant stakeholder in the development of the new maximum pricing rule for embedded networks under the General Exemption Order.

Active Utilities believe we can offer the perspective of a company operating in the Embedded Network sector. We have followed the development of the VDO closely and have presented various submissions throughout this process.

As an initial step, Active Utilities would like to advise the ESC of our intention to deliver a submission in relation to the development of the maximum pricing rule for embedded networks by the 12th July 2019.

If you would like to collaborate further with Active Utilities on the development of the new maximum pricing rule please contact myself at [REDACTED]

Kind Regards

Kyle Johnson
Risk & Compliance Manager
Active Utilities Pty Ltd