

**ACTIVE**

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**Submission:**

**Maximum prices for embedded networks and  
exempt sellers: Consultation Paper**

**March 2019**

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10<sup>th</sup> March 2020

**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 Maximum prices for embedded networks and exempt sellers: Consultation Paper**

Thank you for the opportunity to comment on the ESC's Maximum prices for embedded networks and other exempt sellers: Consultation paper, published on 11<sup>th</sup> February 2020.

Active understand that the ESC's initial view is that the Victorian Default Offer (VDO) is an appropriate price for the cost of selling electricity in an embedded network. ESC is therefore proposing to extend the coverage of the VDO to all exempt sellers and their customers in embedded networks.

Active agree with the ESC that the VDO cost stack methodology and the categories of the cost stack are appropriate to apply to exempt sellers. However, Active disagrees that the current VDO pricing established for retailers, and initially not applied to embedded networks so further due consideration could be afforded to the appropriate maximum price, does not reflect the efficient costs of the sale of electricity in Victoria by an exempt seller. This is demonstrated in further detail below.

Active believe the ESC's intent in applying the VDO framework to exempt sellers is due to the cost associated with alternative approaches (such as assessing a cost-stack specifically for exempt sellers). Although Active agree with the principles used in this decision, there has been no evidence presented to stakeholders that the costs outweigh the benefits in this situation. Furthermore, Active offer evidence to the ESC that indicates there are material difference in the cost of exempt sellers providing electricity services.

In our experience efficient exempt seller costs are materially different from an efficient retailer. Active believe if the ESC were to extend the methodology of the VDO to a maximum price cap without exploring these price differences will be detrimental to the sector.

Active therefore propose a hybrid alternative where the VDO framework and cost stack is applied to exempt sellers, with an additional exempt seller cost added to the cost stack to reflect the different pricing in the areas of:

1. Wholesale Costs
2. Network Costs
3. Retail Operating Costs

This hybrid alternative is visually demonstrated at Appendix 1. This alternative will ensure a separate cost stack approach, calculation and methodology is not required by the ESC, which will save costs whilst ensuring reflective material differences are identified and added to the cost stack via an additional 'exempt seller cost'

Active have been proactive throughout both the implementation of the VDO and throughout the Victorian Government's request for the ESC to develop a new maximum pricing rule. Active have also provided a redacted version of our 'cost to serve' calculation methodology to provide some further certainty to ESC in previous submissions. Active are committed to getting the balance right on the maximum price cap, therefore are committed to providing our retail operating costs to the ESC to demonstrate that our cost to serve is higher than a market retailer. This is further explained in this submission.

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

## MATERIAL DIFFERENCE

Active agree with the cost stack methodology of the VDO is appropriate and the categories of the cost stack are an appropriate benchmark. However, Active disagrees that the current VDO pricing does not reflect the efficient costs of the sale of electricity in Victoria by an exempt seller. This is demonstrated in further detail below.

Furthermore, as stated by the ESC, the maximum price cap for exempt sellers will form a hard cap on the price exempt sellers can offer our customers. This is different to the VDO which applies to standing offers and does not restrict retailers from making market offers that differ from the VDO which is a large material difference.

Active believe the intent of the ESC in applying the VDO framework to exempt sellers outweighs the cost associated with alternative approaches (such as assessing a cost-stack specifically for exempt sellers). Although Active agree with the principles used in this decision there has been no evidence presented to stakeholders that the costs outweigh the benefits in this scenario. Furthermore, Active offer evidence to the ESC that indicates there are material difference in the cost of exempt sellers providing electricity services.

Active therefore propose a hybrid alternative where the VDO framework is applied to exempt sellers with different pricing in the areas of:

1. Wholesale Costs
2. Network Costs
3. Retail Operating Costs

These are explained in further detail below.

## WHOLESALE RISK

Active agree with the ESC's statement that "retailers usually manage the wholesale risk exposure for the exempt seller"<sup>1</sup>. However, as an exempt seller, we are purchasing a product from a retailer who has added a margin to their wholesale cost (including the

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<sup>1</sup> Essential Services Commission, Maximum prices for embedded networks and other exempt sellers – Consultation Paper, 5 February 2019, p.7.

volatility assessment) when selling to exempt sellers. Therefore, the retail margin for exempt sellers is reduced as our wholesale costs are usually more than the wholesale price applied in the cost stack that contributes to the proposed maximum price cap.

Active proposes, as demonstrated in Table 1 (below) that the cost stack approach, for the wholesale component includes the following methodology:

$$\text{VDO Wholesale cost} \times \text{Retail Operating margin} = \text{EN Wholesale cost}$$

The EN Wholesale cost should be the cost applied to exempt sellers when applying the cost stack methodology. This will ensure exempt sellers' margin is not eroded by purchasing electricity off retailers above the calculated wholesale cost applied to the VDO.

**Table 1: Proposed Wholesale costs for Embedded Networks and Exempt Sellers**

Distributor	Segment	Wholesale VDO* <sup>2</sup>	EN Wholesale Margin <sup>3</sup>	Applied EN wholesale* cost
Ausnet	SME	112.38	5.70%	118.78566
CitiPower	SME	115.32	5.70%	121.89324
Jemena	SME	114.85	5.70%	121.39645
Powercor	SME	110.22	5.70%	116.50254
United Energy	SME	116.95	5.70%	123.61615
Ausnet	RESI	121.33	5.70%	128.24581
CitiPower	RESI	118.11	5.70%	124.84227
Jemena	RESI	126.28	5.70%	133.47796
Powercor	RESI	119.2	5.70%	125.9944
United Energy	RESI	127.27	5.70%	134.52439

\*Price = \$ per MWh

<sup>2</sup> Essential Services Commission, Victorian Default Offer to apply from 1 January 2020 – Final decision, 18 November 2019, p.55.

<sup>3</sup> Essential Services Commission, Victorian Default Offer to apply from 1 January 2020 – Final decision, 18 November 2019, p.59.

## NETWORK COSTS

Active understand that the VDO methodology applies a cost pass-through approach for estimating network costs using the simplest network use of system tariff in each distribution zone – generally a daily supply charge and a flat usage charge. These are directly taken from tariffs approved by the AER.

As Table 2 (below) demonstrates, Active Utilities, as an exempt seller, has significantly different network costs changes than a retailer. Active believes this would be similar for all exempt sellers.

**Table 2: Network costs & differential between Retailers and Embedded Networks**

Distributor	Segment	VDO Network charge % increase 2020 <sup>4</sup>	EN Network charge % increase 2020 <sup>5</sup>
Ausnet	RESI	2.50%	10.62%
CitiPower	RESI	2.50%	7.36%
Jemena	RESI	2.50%	6.89%
Powercor	RESI	2.50%	10.83%
United Energy	RESI	2.50%	13.58%
Ausnet	SME	3.00%	10.62%
CitiPower	SME	3.00%	7.36%
Jemena	SME	3.00%	6.89%
Powercor	SME	3.00%	10.83%
United Energy	SME	3.00%	13.58%

For simplicity, Active recommends, when acquiring a network cost price and subsequent percentage increases for the exempt seller cost stack approach, ESC applies an additional adjustment (exempt seller cost) to the cost stack based on an average change in 'Commercial and industrial rate tariff' for each applicable distribution zone. This will insure a more cost reflective approach on percentage changes to network charges for exempt sellers.

<sup>4</sup> Essential Services Commission, Victorian Default Offer to apply from 1 January 2020 – Final decision, 18 November 2019, p.V.

<sup>5</sup> Percentages collated by Active Utilities using a weighted average of our 2020 Network charge percentage increases per distribution zone and segment.

## RETAIL OPERATING COSTS

Active believe there is a material difference in a cost to serve between a retailer and an exempt seller. The main reason for this material difference is due to 'economy of scale' which ensures a proportionate saving in costs gained by an increased customer base. An exempt seller, by its very nature, has a reduced economy of scale due to being limited by the customer base only being customers within an embedded network it operates.

The reduced economy of scale for exempt sellers as an issue has also been acknowledged by the Department of Environment, Land, Water and Planning (DELWP)<sup>6</sup>

As demonstrated below, the operating cost differences between an Efficient Retailer and Efficient Exempt Seller are significant. To provide further evidence of an Efficient Exempt Seller's retail operating costs, Active are prepared to show the ESC our calculations on a private and confidential basis. If the ESC wishes to discuss this further, please contact us.

### Operating Costs differential table between Retailer and EN

	Efficient Retailer	Efficient Exempt Seller
Retail Operating Costs	\$136.00 <sup>7</sup>	\$228.00 <sup>8</sup>

<sup>6</sup> Department of Environment, Land, Water and Planning 2017, Review of the Victorian electricity licence exemption framework – Final position paper, p.9.

<sup>7</sup> Essential Services Commission, Victorian Default Offer to apply from 1 January 2020 – Final decision, 18 November 2019, p.59.

<sup>8</sup> Active Utilities Pty Ltd, Submission to the Essential Services Commission – Maximum Pricing Rule for Embedded Networks Final decision, July 2019, p.9.



## CUSTOMER PROTECTIONS

Active notes the DELWP's request that the framework should be designed to give customers of exempt sellers a comparable level of consumer protections and services<sup>9</sup>.

Active believe customers should have the highest afforded levels of protection, therefore propose the solution that all embedded network customers can request the exempt seller to place them on the current VDO if requested. This is in line with current retailers and market customer protections.

## QUESTIONS FOR STAKEHOLDERS RESPONSE

### Question 1:

**Are there any other issues we should consider in our framework for formulating a maximum price for embedded networks?**

Yes, the difference in costs as evidenced in this submission. In particular

- > Wholesale risk
- > Network costs
- > Retail Operating costs

### Question 2:

**Is there any other information we should consider in having regard to commercial market data?**

Yes, The ESC should lobby the AER to remove the ability of builders and networks to enter 'utility sweetheart deals', where the builder avoids paying connection fees and enters a contract for demand instead.

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<sup>9</sup> Essential Services Commission, Maximum prices for embedded networks and other exempt sellers – Consultation Paper, 5 February 2019, p.14.

**Question 3:**

**We are interested in stakeholder views on the VDO tariff types outlined above and how they might be applied in the context of a maximum price for exempt sellers. What do you see as the advantages / disadvantages of each option?**

**Flat tariff:**

- > Advantage:
  - Simple to implement and majority of residential customers will fit into this category
- > Disadvantage:
  - Disincentives customers to use energy in off peak periods.
  - Majority of business are on TOU's in an embedded network

**Maximum annual bill**

- > Advantage:
  - Simple to implement and majority of residential customers will fit into this category
  - Majority of business are on TOU's in an embedded network
- > Disadvantage:
  - Harder to set supply and variable charges

**Question 4: What types of tariffs are currently offered by exempt sellers? On what basis do exempt sellers currently determine tariff structures?**

Active would be open to both a maximum price and a maximum bill with a ½ hour profile, that would provide maximum flexibility. This is based on the provision that embedded networks need to stay under one of the options.

For SME's a TOU option needs to be considered as most Active's commercial customers are on TOU.

**Question 5:****Are there any other issues in relation to tariff structures we should consider?**

Active believe any demand costs needs to be excluded from a price cap in relation to maximum rate's and maximum bills.

**Question 6:****We are interested in stakeholder views about any implementation issues. Please provide evidence to support your views.**

As electricity retailers have just completed a price change recently, Active believe implementation should occur on 1 January 2021 for greenfield developments due to significant costs involved in conducting price changes.

**Question 7:****Is there any other information we should consider?**

Active proposes that for existing embedded network sites, a transition period of 12 months, with a 1 Jan 2022 final date should be implemented. This is due to wholesale costs being locked in for future periods by exempt sellers.

## APPENDIX 1

### VDO AND PROPOSED MAXIMUM PRICE CAP VISUAL

