

17 October 2019

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

amaysim Submission on the ESC's Victorian Default Offer Draft Decision

Introduction

This submission relates to the Draft Decision on the Victorian Default Offer (**VDO**) to apply from 1 January 2020, released by the Essential Services Commission (**the Commission**) on 20 September 2019 (**Draft Decision**).

amaysim aspires to be Australia's best customer-focused utilities service provider. amaysim is accordingly focused on developing innovative offerings that put the customer first – having a Victorian Energy Market that fosters competition and delivers on customer outcomes is of upmost importance to amaysim. Our submission responds to the major elements of the Draft Decision and elaborates further on past points raised by amaysim within previous VDO submissions.

We would be pleased to discuss this submission with you directly.

Background on amaysim

amaysim entered the energy market in 2017 when it acquired the Click Energy Group. We retail electricity and gas to over 80,000 residential and small business customers in Victoria, and over 200,000 customers nationally.

amaysim is a tier two energy retailer offering innovative products in competition with the major energy retailers (including gentailers). Competition from tier two retailers is vital to ensuring that tier one energy retailers are not able to utilise their market position to the detriment of Victorian Consumers. It is important that the VDO continues to provide a safety net for those consumers that are unable to engage with a complex market, while at the same time allowing retail diversity and innovation to ensure customers benefit from the next generation of retail offerings. amaysim is well placed and committed to ensure that customers have products that are tailored to their individual needs, and that these products are user-friendly and provide genuine value.

Wholesale costs

As we have stated in earlier submissions to the Commission, historical spot prices should not be used to predict future spot prices. In particular, using spot prices that include data from 2016-2017 data is inappropriate, given data from that financial year reflects a structurally different generation market. The best representation of future spot prices (without specifically modelling them) are the forward prices published by the ASX. These represent expected future spot prices. However, futures price should be discounted, removing a risk premium, to achieve a comparable spot price.

Further, amaysim submits that ASX energy contract prices should be updated with the latest information prior to the release of the final decision on the VDO. This will ensure that forward energy prices best reflect the actual costs of energy retailers for the 2020 calendar year.

Hedging

The Commission has continued to utilise the Frontier Economics methodology for the upcoming price reset but appear to have changed some key inputs for the Draft Decision.

Most relevantly, the Commission has expanded the spot price data period to now include the last three years' worth of data, whereas in the previous VDO advice, the Commission chose to limit the spot price data to a two-year period. This data feeds into the load and price profiles that an efficient retailer would use to hedge their wholesale book. As noted above, the 2016-17 Victorian generation market had a very different composition to what we see now. amaysim submits that the Commission should consider the suitability of all its data sets to ensure that the data is an accurate representation of how an efficient retailer would manage wholesale risk in the actual year to which the VDO will apply.

The level of risk that retailers choose to accept differs markedly throughout the industry. amaysim would like to reinforce the observation we have made in our previous submissions that, like many other tier two (and below) retailers, amaysim is not vertically integrated and relies on generators and other counterparties to hedge its exposure to spot market volatility and compete with vertically integrated energy companies (who are not exposed to volume risk) on a like-for-like basis. It follows, vertically integrated retailers (a retailer with generation capacity) face significantly different risk profile to a tier two retailer without generation capacity.

The Commission's current approach to calculating costs is heavily weighted towards vertically integrated retailers (a retailer with generation capacity) who are naturally hedged against market volatility. We submit that the Commission should therefore adjust the cost stack to be more in favour of tier two retailers to take into account, and allow for, the additional wholesale costs which the non-gentailer retailers incur in managing spot risk (e.g. by hedging).

Environmental costs

The revision of environmental charges, particularly around the future cost of LRET, have had a significant impact upon the overall price level of the VDO to apply for 2020. amaysim supports the use of publicly available market data around certificate prices to set environmental costs. However, the Commission needs to consider that businesses have a forward looking horizon to managing risk for the various environmental schemes. For example, LGC prices have generally been purchased in large blocks well in advance of the 2020 year, so the price locked in by prudent retailers managing risk efficiently may be weighted more closely towards 2019 LGC prices. The forward prices observed currently in the market will likely have a larger impact on future years LRET prices rather than the upcoming year.

Network prices

In the ACCC's Final Report on electricity affordability (the **ACCC Report**)¹, the ACCC concluded that network costs contribute 35% of the total increase to average customer bills and 38% to average residential customer effective prices. In addition, the ACCC report also concluded that network costs currently represent approximately 42% of the average residential customer's bill (whereas retail margin currently represents approximately 8%). It follows, the ESC must give appropriate weighting to network costs in its analysis of the 2020 VDO cost structure.

The Commission proposes to set the maximum annual bill for Time of Use (**TOU**) and Flexible tariffs equal to the maximum annual bill for the flat tariff in the relevant network. This proposal is not allow to be price reflective because the average network tariffs varies depending of the tariff structure.

The following table compares the average network tariffs by distributor for customers on Peak Only, TOU or Flexible tariffs. For both residential and for business customers, there are cases when the average network tariff for a TOU or Flexible Tariff customer is higher than the network tariff for a Peak Only customer.

¹ Australian Competition and Consumer Commission, (Restoring electricity affordability and Australia's competitive advantage), Retail Electricity Pricing Inquiry – Final Report, June 2018 (**ACCC Report**).

Network	Residential (4,000 MWh)			Business (20,000 MWh)			
	Peak Only	TOU, 5 Day	Flexible	Peak Only	TOU, 5 Day	TOU, 7 Day	Flexible
Jemena	\$482	\$479	\$471	\$2,355	\$1,918	\$2,183	
United	\$481	\$481	\$468	\$2,378	\$1,889	\$2,077	
Ausnet	\$645	\$664	\$585	\$3,585	\$2,620	\$2,507	
Powercor	\$527	\$559	\$542	\$2,006	\$2,059	\$2,287	\$1,587
Citipower	\$446	\$477	\$504	\$1,975	\$1,927	\$1,895	\$2,220

It is also noted that recently released Draft Tariff Structure Statements² have indicated that network prices in Victorian Distribution Businesses for small use customers will increase by a level much higher than that indicated in the Draft Decision. amaysim believes that, in the interests of transparency, the Commission should publicise that these increases will lead to a higher VDO for 2020.

Network	Residential (4,000 MWh)			Business (20,000 MWh)		
	CAL19	CAL20	Variation	CAL19	CAL20	Variation
Jemena	\$450	\$482	7%	\$2,175	\$2,355	8%
United	\$441	\$481	9%	\$2,127	\$2,378	12%
Ausnet	\$578	\$645	12%	\$3,075	\$3,585	17%
Powercor	\$492	\$527	7%	\$1,832	\$2,006	9%
Citipower	\$427	\$446	5%	\$1,842	\$1,975	7%

Loss Factors

amaysim once again requests the the Commission reconsider its distribution loss factors (DLF) calculations. The Commission estimates the network losses relying on data available from AEMO for DLF and marginal loss factors. DLF depends on the network, and the type of line (either short sub-transmission or long sub-transmission). The DLF related to long sub-transmission lines is higher than the DLF for short sub-transmission lines. In the VDO analysis, the Commission considers only the short sub-transmission line is relevant. For those customers on long subtransmission lines, the DLF factor adopted by the Commission does not adequately compensate retailers. Therefore, the VDO network losses are underestimated and should be weighted by the customer numbers on each type of line.

Retail Operating Costs

The Commission adopted a modest increase in retailer operating costs to account for regulatory costs. This recognition of the impact of regulatory changes is welcomed by amaysim. However the modest increase does not adequately reflect the recent additional costs imposed by the Victoria specific regulatory changes introduced over recent years. amaysim notes that the introduction of the recent suite of regulatory reforms in Victoria, most notably the Victorian Default Offer, Best Offer and the Clear Advice Entitlement has resulted in a significant increase in regulatory costs.

amaysim still believes that the Commission has not given appropriate weighting to variety of business models that exist in the retail sector. The VDO operating costs allowance still appears to be established for a large vertically integrated businesses with generation assets. The Commission should utilise the data submitted to it for tier two retailers to revise the retail operating costs to ensure that VDO does

² Draft Tariff Structure Statements, as submitted to the AER by Jemena, AusNet, United Energy, Jemena and CitiPower, accessed at <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/pricing-proposals-tariffs>

not entrench the business models and dominance of the tier one retailers.

amaysim submits that the retail operating margin should be higher to reflect the higher retail operating costs of tier two retailers, who spend more on customer acquisition and the provision of customer service. amaysim once again argues that the estimate used in the final advice for customer acquisition and retention costs was out of date, and that more recent data from the ACCC inquiry final should be used.

VDO compliant maximum annual bill

The Commission has adopted a methodology to calculate the maximum bill that was most broadly supported by industry.

Of the options considered by the Commission in its Draft Decision, it is amaysim's view that the most sensible approach has been adopted. However, the intention of the VDO was to establish a fair, simple and understandable product for those customers that either chose not to, or were unwilling to, engage in the competitive electricity market. Given that purpose, the need to offer anything but a flat VDO seems questionable. Having a single comparison point is both easier for customers and is likely to foster innovative offerings in the market without creating unnecessary and confusing comparisons for consumers. amaysim would support any initiative undertaken by the Government or the Commission that would mandate distribution businesses to change the network tariff to flat should a customer access a flat VDO. This change would be an essential addition to any adoption of a single flat VDO.

The VDO is intended to be a simple product that customers can understand easily. Having multiple VDO price points across TOU pricing is likely to stifle competitive and innovative offerings. amaysim has preference for a flat VDO only, for those customers that are not willing or are unable to engage with the market. For those customers that are willing to engage with the market by considering retail products that suit their needs and circumstances, multiple VDO price points is likely to cloud decisions and ultimately lead to consumers missing out on better market offers and products. It would be beneficial for consumers if the VDO alternative was simple and easy to understand.

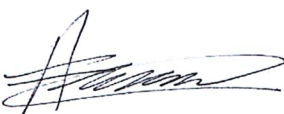
amaysim maintains that innovative product constructs such as our subscription products should be exempt from the compliant maximum bill framework. The Commission runs the risk that VDO will compel retailers to offer one single product that mimics their competitors. Given the rate of technological change in the sector, and the exciting developments for households in the way they choose to generate and consume energy, innovative energy products will be key in facilitating consumers benefiting from rapid change. amaysim suggests that there should be a framework in place to allow innovative products to be completely exempt from the VDO framework and the need to calculate a maximum bill for these products. amaysim would welcome the opportunity to work with the Commission and policy makers to develop this framework.

Conclusion

amaysim notes that retail price setting in the electricity sector is never a simple or precise task and asks the Commission to consider this submission with an open and constructive mind.

We would welcome the opportunity to discuss our recommendations with you. Please contact our Senior Legal Counsel, Andrew Medicott (whose email address has been provided separately) should you wish to do so.

Yours faithfully



Alexander Feldman
Chief Strategy Officer & General Counsel