momentum energy

20 October 2020

Ms Kate Symons
Chairman
Essential Services Commission of Victoria
Level 37, 2 Lonsdale Street
Melbourne VIC 3000.

Submitted online: https://engage.vic.gov.au

Dear Ms Symons

Victorian Default Offer to Apply from 1 January 2021

Thank you for the opportunity to provide a submission in response to the Draft Decision on the VDO for 2021 (the Draft Decision).

Momentum Energy is a 100% Australian-owned and operated energy retailer. We pride ourselves on competitive pricing, innovation and outstanding customer service. We retail electricity in Victoria, New South Wales, South Australia, Queensland and the ACT. We offer competitive rates to both residential and business customers along with a range of innovative energy products and services. We also retail natural gas to Victorian customers.

Momentum Energy is owned by Hydro Tasmania, Australia's largest producer of renewable energy.

Introduction

Momentum acknowledges the Essential Services Commission's (the Commission's) requirement to make a decision in line with the Pricing Order which it has been provided however, we are also cognizant of its statutory objective to "promote the long term interests of Victorian consumers."[1]

Like the Commission, Momentum agrees that the objective of the VDO – to provide a simple, trusted and reasonably priced electricity option that safeguards consumers unable or unwilling to engage in the electricity retail market – is consistent with promoting the long term interests of consumers. We do not believe however, the Draft Decision is consistent with this objective as it fails to account for increases in operating costs and consequently undermines retailer viability.

[1] *Essential Services Commission Act* 2001 s 8.

Momentum does not believe that the methodological approach to the wholesale environmental components is optimal, however, we believe that the Commission's approach is generally reasonable. Consequently this submission will focus on elements of greater materiality.

While the circumstances surrounding the 2021 VDO decision differ somewhat to previous periods, the failings in the Commission's methodological approach remain the same in that retailer costs are ignored because they cannot be adequately forecast and because no mechanism to true up any differences on an ex post basis exists.

Timing/Duration of Regulatory Period

We appreciate that the Commission is constrained by statutory timings relating to the publication of VDO prices. We note that a 12 month regulatory period will result in VDO and network price change timings being misaligned for the foreseeable future. We believe that this presents an opportunity for the ESC to mitigate the risk that retailers face from the setting of prices for a 12 month period in the current environment as well as taking immediate action to result this timing misalignment.

Price regulation imposes risks under the best of circumstances. Any determination is made of forecasts, and as famed economist Edgar Fielder wrote "No one can escape the iron rule that once you make a forecast, you know you're going to be wrong; you just don't know when and in which direction!". In such uncertain times as these, the best insurance against this iron rule is to ensure that regulatory periods are shorter so that forecasts can be revised.

It is disappointing that the Commission and Victorian Government did not anticipate, and work to avoid, the complications that their policies would have on the VDO setting process. Momentum is sympathetic to the idea of the best laid plans being subverted by a lack of regulatory and policy coordination, but we do not believe that it is appropriate that the Commission transfer a risk which could have been foreseen and avoided onto the retail sector.

We also note that the Commission has not proposed a solution to the issue of network reprice/VDO timing misalignment and retailers will continue to bear this risk. Customers will face ongoing confusion and inconvenience until it is resolved.

In order of preference, Momentum believes that the best options to proceed are:

1. An extension of the current VDO price determination until 1 July 2021 followed by annual 12 month regulatory periods;
2. A six month VDO determination commencing 1 January 2021 followed by 12 month regulatory periods from 1 July 2021; or
3. A seven month VDO determination commencing 1 January 2021, followed by an 11 month determination from 1 August 2021 with annual 12 month determinations from 1 July 2022 onward.

We appreciate that this may place pressure on the Commission to complete a new determination within a relatively short period however, however this situation is identical to that faced by retailers immediately prior to the VDO where publication of Standing Offer Tariffs was required on a set date very shortly after final network prices were determined. We note that the Commission and Victorian Government were unsympathetic to the challenge faced by retailers during this period.

Cost to Serve

Momentum is deeply disappointed that the Commission has not attempted to quantify the substantial increases that retailers have and will continue to face in their operating costs. Since the start of the pandemic, the retail energy industry has been exposed to significant disruption. Retailers have invested in tools and equipment to allow staff to work from home to ensure that customers are not inconvenienced by disruption faced by businesses. They have also faced significant increases in consumer debt and changes to this debt profile.

The draft decision states that retailers have been unable to quantify cost increases and this is true. This is however due to the uncertain nature of the current pandemic situation and the fact that any figures provided will be forecast rather than actual and therefore cannot be empirically quantified. We note that this approach and the need for firm evidence is not applied with regard to potential cost reductions which appear to be asserted without evidence from some stakeholders. Momentum shares the view of consumer groups that the VDO should be as low as possible however, it must represent the true cost of supplying energy to customers and the benchmark cannot be lowered without strong evidence to suggest that this is in fact happening.

To support this, Momentum provides the following confidential data relating to our cost to serve.

[redacted]

(noting that Momentum was already providing assistance to customers with URGS applications and so avoided the additional cost of this change).

In previous submissions we have urged the Commission to conduct thorough cost benefit analyses of reforms in order to ensure that they provide a net benefit to Victorians. We once again suggest that this important step is undertaken as it will provide the Commission with better visibility of the costs associated with complying with the Victorian regulatory framework.

COVID Costs – Mechanism for ex-post adjustments

Momentum considers that a deep flaw exists in the current VDO setting framework in that there is no mechanism for ex-post adjustments. As outlined above, retailers can only forecast costs for future years and although they can manage challenges such as COVID-19 once they have eventuated, 12 months ago discussions relating to costs arising from a global pandemic would have seemed inconceivable.

Price regulation imposes risks on retailer if the prices set do not factor in all reasonable costs. Conversely, consumers suffer if prices are set at a level which overstates the costs that retailers face (although this is mitigated considerably with the availability of market offers to consumers). These risks could be lessened if the Commission considered a mechanism to allow for ex-post true ups where forecast costs are materially different to actuals.

[redacted]. As it stands, the Commission's calculation of the VDO disregards any past expenditure and as this amount was not forecast in the 2020 VDO, this legitimate expense is unrecoverable. With regard to the 2021 VDO, the Commission is seeking a level of certainty that retailers are unable to provide on forecast costs and consequently it is likely that these costs will once again constitute a deadweight loss as they will need to be recovered through market offers. An ex-post true up mechanism would allow any over or under estimate of costs to be reconciled in future periods.

We further believe that past costs should be allowable in the VDO decision because retailers' ability to manage risk has been diminished. Appreciating that retailers' social contract dictates an additional focus on customer wellbeing during a pandemic period, retailers halted disconnections for non-payment. This approach heightened the need to focus on revenue leakages which would not lead to customer detriment so Momentum focused on disconnections of vacant premises however, networks have often refused to carry out service orders. On this basis, retailers have been forced to maintain supply to vacant properties and pay the associated network charges as well as voluntarily constraining the usual debt management activity of disconnection for non-payment. We note that network businesses also took some steps to minimise customer detriment through the deferral, and in some cases waiving, of charges however these they have the benefit of being able to factor these costs into future regulatory periods and therefore they will be able to recover their costs. This has resulted in an equitable burden being placed on retailers which the Commission should have regard to in determining the manner in which the VDO is determined.

Productivity Factor

We are pleased to see that the Commission has not adopted a productivity factor for the draft determination. While we understand the superficial attraction of a productivity factor, we do not consider that it is an appropriate mechanism in a competitive market. Productivity factors are primarily a tool used in monopoly price regulation to provide an incentive for efficiency where one would not otherwise exist. In energy retail, competition provides the impetus for efficiency, and retailers who achieve efficiency are rewarded with higher margins. This higher margin is often diminished by the forces of a competitive market. A productivity factor which assumes efficiencies when there is no evidence that they exist serves no purpose but to artificially reduce the VDO price below the efficient level.

The Commission's reliance on publicly reported results represents a very small sample size of the industry. As outlined in our operating cost data provided above, retailers do not generally have scope to pursue efficiencies because of the constant change to processes being necessitated by regulatory reform. Productivity increases are gained through investment in systems and processes to refine operations and seek efficiency. [redacted] Moreover, the constant change has led to a state where often changes must be implemented through workarounds and temporary fixes rather than as optimum solutions which can result in systems operating in sub optimal states. We would assume that other retailers are similarly impacted.

While the Commission has cited the uncertainty surrounding COVID as the reason for not adopting a productivity factor, we are concerned that there is no genuine regulatory rationale for a productivity factor even under normal circumstances in a competitive market, particularly where the pursuit of efficiency is hampered by regulatory reform.

With the above comments in mind, we look forward to continuing to engage to assist the Commission to determine a VDO price which reflects efficient retailer costs and is consistent with promoting the long terms interests of Victorian consumers.

Should you require any further information regarding this submission, please don't hesitate to contact me on 0413 266 081 or email joe.kremzer@momentum.com.au.

Yours sincerely

[Signed]
Joe Kremzer
Head of Regulatory Affairs