Victorian Default Offer 2023-24

Submission received via Engage Victoria on our consultation paper on Victorian Default Offer 2023-24

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Organisation: Energy Locals Pty Ltd

What are your views about our proposed approach to setting the 2023–24 Victorian Default Offer?

We agree that the existing methodology of using the average futures contract prices from the past 12 months weighted by the trades at each price is broadly appropriate.

Consideration should be given to using the average of the daily closing price in lieu of the trade weighted volumes to allow for the current lack of liquidity on the exchange. Liquidity decreased significantly post the market volatility that started around June 2022, at times when volume would normally be high as the start of the contract period approaches. This coincided with the step change in the wholesale price.

Using contract prices and traded volumes from the ASX does not fully reflect the actual source of hedges, as small retailers face difficulties accessing the ASX and depend on OTC trades, which generally have higher costs. Clearing houses have been charging multiples of the ASX margins due to volatility in the market. We believe that these costs should be included in the VDO calculation because they reflect the reality of market participation costs nowadays.

Retailers also face higher cost of capital to finance increased prudentials and margin calls. These costs are becoming more significant in an environment of rising interest rates. Furthermore, given that these costs can spike during times of wholesale disruption, retailers are forced to maintain financing facilities, which also increase operating costs.

In addition, small retailers now incur the cost of unaccounted for energy, which was previously charged to Tier 1 retailers only.

Do you think that the costs associated with the Australian Energy Market Operator's June 2022 interventions in the wholesale market should be reflected in the Victorian Default Offer? Why/Why not?

Yes

These costs are real and are charged to the retailers, so should naturally be reflected in the VDO. Where costs are not fully known by the time the VDO is determined, we support using a best estimate approach. Delaying the inclusion of the costs further will force retailers to carry that cost for an inappropriate amount of time.

What are your views on using a variation mechanism for market intervention costs?

We believe that a best estimate approach should be used to include the June 2022 intervention costs. Once the actual costs are known, a true up can be added to the 2024-25 VDO. This would ensure that retailers do not have to carry the costs for an additional year.

Do you think we should make changes to our retail cost benchmarks? Why/Why not?

Yes

Energy Locals broadly agrees with the categories included in the retail cost component of the VDO. We also agree that increasing the benchmark by CPI is appropriate as it broadly reflects the increase in our cost base. Energy Locals aims to maintain real wages for our employees which means that our cost base tracks CPI. In addition, the tight labour market leads to a strong competition for talent with an impact on labour costs.

Furthermore, we have seen some suppliers increase costs to us by more than CPI.

The CPI measure is also a simple, easily understood indicator which aids transparency.

The cost impact of the consumer data right on retailers is significant. For Energy Locals, it will cost [redacted] to implement this across our suite of systems.

Do you think we should make changes to our customer acquisition and retention cost benchmark? Why/Why not?

Yes

Customer acquisition and retention costs are part of doing business for retailers. This is especially the case for small retailers looking to grow and provide competition in the market.

We believe that CPI is an appropriate measure to increase the benchmark by. It is transparent and easily understood as well as reflecting the change in marketing and channel costs.

Do you think we should publish consultation papers in addition to our draft decision papers in future Victorian Default Offer reviews? Why/Why not?

No

Consistency and transparency are important factors in the VDO methodology and help retailers with their planning and hedging processes. However, given that the VDO is now well established we believe that consultation papers are only required where there is a change in methodology.

Are there any other matters the commission should look into?

Increased financing costs

We believe that the retail margin needs to be adjusted for the significant increase in financing cost faced by retailers.

Following the wholesale market disruptions that started in June 2022, the industry faces higher capital requirements to meet security demands from hedge providers and AEMO, including funding to meet short-notice cash calls from the market operator. This is resulting in a significant additional cost in an environment of higher interest rates which should be included in the cost base.

Embedded networks

We disagree with the VDO acting as a price cap for embedded networks, especially given the fact that there will be a requirement for embedded networks to offer renewable energy, which is not a requirement for on-market customers.

Implementing a price cap without capping input prices will undoubtedly lead to business failures and disruptions to the services promised to customers. A similar scheme in the United Kingdom, where amounts that retailers can charge for utilities were capped while those retailers were still exposed to uncapped input prices, has led to the failure of 28 energy suppliers since June 2021, costing consumers £2.8bn (as reported by the Guardian on 22 June 22). It would expose embedded network operators to the full impact of market failures, similar to the one that happened between June and August 2022 and potentially crippling companies who are unable to increase costs to customers because of the government's energy price cap. This risk would reduce competition, leaving only large integrated retailers able to supply the market, essentially harming consumers by increasing prices in the long term.

In addition, embedded networks offer their customers additional benefits, such as on-site renewable energy generation, battery storage, and electric vehicle chargers at zero up front cost to customers. These costs are usually recovered from customers over the life of the assets but are not factored into the regulated pricing methodology. A price cap will reduce the use of these new energy technologies in these buildings, or alternatively will drive up the cost of ownership or rental if they are included.