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24 January 2023

Essential Services Commission
Level 8, 570 Bourke St
Melbourne VIC 3000

Lodged via Engage Victoria

Dear Commissioners,

Re: Victorian Default Offer from 1 July 2023 – consultation paper

Simply Energy welcomes the opportunity to provide feedback on the consultation paper on the Essential Services Commission's (Commission) draft decision on the Victorian Default Offer (VDO) price determination to apply from 1 July 2023.

Simply Energy is a leading energy retailer with approximately 700,000 customer accounts across Victoria, New South Wales, South Australia, Queensland and Western Australia. Simply Energy is owned by the ENGIE Group, one of the largest independent power producers in the world and a global leader in the transition to a zero-carbon economy. As a leading retailer focused on continual growth and development, Simply Energy supports the development of effective regulation to facilitate competition and positive consumer outcomes in the market.

While Simply Energy understands the reasons behind the introduction of the VDO, Simply Energy does not support price regulation in competitive markets. While we recognise the challenges in anticipating that wholesale prices would continue to increase significantly following the publication of the VDO 2022-23 price determination, we consider the events of mid-2022 demonstrate the challenges in setting regulated electricity prices in a rising price environment.

Overarching methodology

Simply Energy notes that the Commission has proposed to largely maintain the methodology used for the 2022-23 VDO. We are comfortable with this approach, and we note that there is no evidence to significantly depart from the current methodology at this stage. While we consider it would be useful for the Commission to undertake a fulsome review of whether the VDO methodology is resulting in VDO prices that meet the policy objectives, this would be a more useful exercise to undertake when market conditions have stabilised.

Market intervention costs

Simply Energy supports the Commission's proposal to include market intervention costs in the VDO cost benchmarks, as these are significant costs that retailers will incur due to the Australian Energy Market Operator's intervention in the wholesale market in June 2022.

We note that the Commission has advised that some of the intervention costs will be known in time for the 2023-24 VDO price determination, while additional intervention costs will be known in the months following the price determination. While it would be beneficial to recover these costs close to the time they are incurred, preparing and implementing price change processes is a costly exercise for retailers and a midcycle price increase is not a good experience for customers. Unless the intervention costs are of a very significant magnitude, Simply Energy would support the recovery of these costs being deferred to the 2024-25 VDO price determination.

Wholesale costs

Simply Energy supports the Commission's proposal to continue relying on its futures market-based methodology to estimate wholesale electricity costs. We consider that the likely increase in the wholesale cost estimate for the VDO 2023-24 price will be due to market factors that are incurred by an efficient retailer, rather than issues with the accuracy or appropriateness of the current methodology.

Retail operating costs and customer acquisition and retention costs

Simply Energy would support the Commission maintaining its current approach to increase its benchmark for retail operating costs in line with changes in the consumer price index each year. The consumer price index is a transparent and accepted approach to escalating regulated prices and we do not consider there is sufficient evidence to suggest that maintaining the current approach would result in a retail operating cost or customer acquisition and retention cost (CARC) estimate that is inefficient.

The methodology should only change if it would be more efficient in the long-term

If the Commission were to move from the consumer price index to a different index (such as the wage price index), this may lead to a similar concern arising in the coming years (that is, that the newly chosen index increases regulated costs at a faster rate than would occur under an alternative index). For example, we note that the wage price index typically has larger annual percentage increases than the consumer price index.[1] Our view is that the Commission should only change its current methodology if it is convinced that it would result in a more accurate representation of cost changes in the long-term, and not because its preferred index is not producing its desired results in the current period.

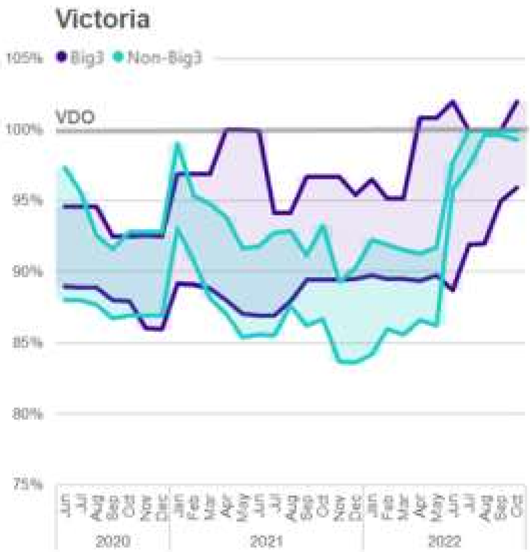
Recent analysis suggests that the VDO may be set too low for retailers to recover costs

Regardless of the methodology chosen, Simply Energy is concerned that the VDO price is currently set too low to enable effective competition in the market. We note that the Australian Competition and Consumer Commission (ACCC) recently noted that regulated retail prices (set by the Commission and the Australian Energy Regulator) have been affecting the ability of retailers to recover their costs and remain financially viable.[2] Analysis from the ACCC's November 2022 report (reproduced below) shows that retailers' market offers had provided noticeable discounts from the VDO until May 2022 when prices begun to converge around the VDO. We urge the Commission to set the retail operating cost estimate (and other cost estimates) conservatively so that the VDO provides sufficient ability for an efficient retailer to recover their costs and provide competitive offerings in 2023-24.

[1] Our analysis of the Consumer Price Index (ABS All groups CPI, Australia A2325846C) and the Wage Price Index (ABS Total hourly rates of pay excluding bonuses, Australia; Private and Public, All industries A2603609J) suggests that the Wage Price Index increased at a faster rate than the Consumer Price Index in 18 of the 22 financial years since the September quarter of 1999. Over this period (until the September quarter of 2022), the Wage Price Index has increased by 100 per cent, while the Consumer Price Index has increased by 87 per cent.

[2] Australian Competition and Consumer Commission 2022, Inquiry into the National Electricity Market – November 2022 Report, 8 December, p. 4, 82 and 83.

Figure - Median of minimum and median of maximum market offers compared with the VDO, residential single rate, June 2020 to October 2022 (big 3 retailers and all other retailers)



Source: Australian Competition and Consumer Commission 2022, Inquiry into the National Electricity Market – November 2022 Report, 8 December, p. 91 – Figure 5.3.

Note: The ACCC sourced this data from Victorian Energy Compare market offer data in October 2022 and is based on usage of 4,000 kWh per annum. The data for November and December 2020 was not available and was replaced with modelled estimates by the ACCC.

The data shows the medians of minimum and maximum market offers for each retailer

The Commission should consider the impact of bad debt costs on retail operating costs

Simply Energy expects that retailers face a risk of above-average bad debt costs in 2023. In addition to the likely increase in electricity prices from 1 July (as well as the gas price increase occurring on 1 February), customers are experiencing significant cost-of-living pressures that have been well publicised in recent months. All these factors will likely result in a higher occurrence of missed bills and escalating debt for customers during 2023.

We note that the Commission removed a temporary $6 bad debt adjustment for the 2022-23 VDO price determination. We consider there is a case to reinstate a bad debt adjustment for the 2023-24 VDO price determination to ensure that retailers have access to a retail operating cost allowance buffer to recover their efficient costs.

The previous bad debt adjustment of $6 was estimated based on public information on retailers' doubtful debt provisions for 2020.[3] We note that any public information on bad debts will be a lagging indicator and will not reflect the bad debt costs that will likely be incurred in 2023. However, public data may provide a useful reference point for the Commission if it decides to

[3] Essential Services Commission 2020, Victorian Default Offer 2021: Final Decision, 25 November, p. 5.

estimate a reasonable adjustment to the 2023-24 VDO price determination to account for forecast bad debt costs in 2023-24.

Retail operating margin

Simply Energy supports the Commission's proposed approach to determining the retail operating margin. As with other cost stack items, we do not consider there is sufficient evidence to significantly depart from the current methodology at this stage.

Concluding remarks

Simply Energy looks forward to working actively with the Commission to ensure that the 2023-24 VDO price determination accurately reflects forecast changes in the cost of supplying electricity retail customers in Victoria.

Simply Energy welcomes further discussion in relation to this submission. To arrange a discussion or if you have any questions please contact Matthew Giampiccolo, Senior Regulatory Adviser, at matthew.giampiccolo@simplyenergy.com.au.

Yours sincerely

James Barton

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