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19 November 2020

Mr Mark Feather
General Manager, Policy and Performance
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Via email to DMO@aer.gov.au

Dear Mr Feather,

Re: Default Market Offer Price 2021-22– Position Paper

Simply Energy welcomes the opportunity to provide feedback on the position paper for the Default Market Offer 2021-22 (DMO 3).

Simply Energy is a leading energy retailer with over 730,000 customer accounts across Victoria, New South Wales, South Australia, Queensland and Western Australia. 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 policy intent behind the introduction of the DMO and considers that the DMO has met the policy intent to date, Simply Energy does not support price regulation in competitive markets.

Simply Energy's submission provides feedback on issues raised in the Australian Energy Regulator's (AER) position paper including: a productivity factor for residual costs, consideration of COVID-19 impacts, the updates to time-of-use usage profiles, and advanced meter costs.

Productivity factor

Simply Energy would not support the introduction of a productivity factor into the DMO methodology.

In regulatory pricing decisions, productivity and incentive mechanisms are often used to simulate competitive market outcomes and incentivise regulated monopolies to reduce costs and share the benefits of cost savings with consumers. In contrast, the competitive nature of the electricity retail market ensures that retailers are already incentivised to become more efficient and pass through cost savings to their customers.

The DMO is not intended to simulate a competitive market price. The DMO was introduced to prevent unjustifiably high standing offer prices and act as a fall-back for those not engaged in the market or those who require the additional protections of standard retail contract terms. In this context, the AER's approach to indexing residual costs by forecast changes in CPI is an imperfect but simple approach to ensure the DMO continues to provide a fall-back price with the necessary headroom for retailers to provide consumers with innovative, competitive and value-added offerings.

As the AER noted in the position paper, introducing a productivity factor would imply a level of precision in the calculation of retail costs that does not exist in the DMO methodology. While the AER's DMO methodology equates residual costs in the cost stack with retail costs, the AER has not estimated the costs that retailers incur in supplying electricity customers. The current CPI indexation approach does not reflect actual changes in retail costs and will not reflect the forecast increase in retail costs during the current economic recession (this is discussed in more detail in the next section). Without a more representative estimate of changes in retail costs, Simply Energy considers it would be difficult for the AER to determine an appropriate productivity factor.

If the AER's concern is that applying CPI indexation will lead to a large disparity between market offers and the DMO price over time, the AER could instead address this through occasional rebasing of the DMO cost stack. To meet the policy objectives and ensure the DMO provides an appropriate safety net, the AER should not set the DMO too high (i.e. the DMO does not prevent excessive standing offers) or too low (i.e. the DMO does not allow retailers to recover their efficient costs or provide competitive offers to consumers). Simply Energy considers that the AER should assess whether the DMO is meeting its policy objectives when considering whether the DMO should be rebased upwards or downwards.

Retail costs related to the economic recession

Simply Energy welcomes the AER's consideration of the cost impacts of COVID-19 in the DMO 3 determination. The impacts of the economic recession resulting from COVID-19 will continue beyond the pandemic and are forecast to result in a significant increase in unemployment. Simply Energy expects that, as well as the existing challenging economic circumstances, any further forecast increases in unemployment will correlate to increases in bad debt expense for retailers.

As retailers will have an increased focus on managing bad debt expense during the recession, there is a risk that retailers will dedicate fewer resources to developing new innovative products and solutions. During the recovery from the recession, it will be important to have strong competition in the retail energy market for the benefit of consumers. For that reason, Simply Energy considers that the AER should ensure the DMO has necessary headroom to enable retailers to provide consumers with new competitive and innovative products.

From Simply Energy's experience, bad debt expense has remained within a narrow range (as a percentage of revenue) in recent years, with unemployment also in a narrow range at approximately 5 per cent. Unemployment during the current recession is forecast to increase to approximately 8 per cent during 2021, and government financial support and mortgage holidays provided by banks are ending in early 2021.

Taken together, reductions in financial support for people impacted by the recession, and increasing numbers of people impacted by it, are expected to put pressure on energy customers, which will see an increase in the bad debt expense carried by retailers (as a percentage of revenue). Simply Energy's assessment is that an increase in unemployment from 5 per cent to 8 per cent will see a commensurate increase in retailer bad debt expense of approximately 50 per cent. For example, a bad debt expense of 3 per cent of revenue with 5 per cent unemployment will become a bad debt expense of 4.5 per cent of revenue with 8 per cent unemployment.

The material change in bad debt expense due to the economic recession will not be captured by the AER's CPI indexation approach and may lead to reduced headroom in the DMO price. When forecasting retail costs for the DMO, Simply Energy considers that the AER should use both CPI increases and information about changes in retail costs that are not related to CPI. In relation to bad debt expense, Simply Energy considers that the AER should include an additional forecast amount, based on the approach presented above, or a similar approach that relates future bad debts to credible forecasts such as the unemployment rate.

Usage profile for time-of-use tariffs

Simply Energy supports the AER's proposal to update the time-of-use usage profiles for more recent data while retaining the simplicity of a one-day usage profile.

Simply Energy considers that the AER's current approach provides a simple methodology that allows consumers to compare time-of-use offers on a like-for-like basis amongst retailers. Simply Energy does not support the development of more granular usage profiles. While there is additional effort and complexity involved in calculating the prices of time-of-use offers on a more granular basis, this is unlikely to improve consumers' ability to compare the relative price of offers amongst retailers. Instead, introducing more granular usage profiles may increase the risk of consumer confusion.

In addition to retailers having difficulty applying a more granular usage profile, the additional complexity may make compliance monitoring more difficult. To encourage consumers to trust and engage in the market, it is important that retailers are producing annual price estimates on a consistent and comparable basis.

Costs to serve customers with advanced meters

Simply Energy considers it is reasonable that the DMO price for flat rate standing offers accounts for the higher costs of advanced metering. As some customers with advanced meters will be paying flat rate tariffs, retailers should be able to recover their efficient costs of serving these customers. It is not appropriate that retailers are expected to solely recover the costs of advanced meters from the subset of customers with advanced meters that have chosen non-flat tariffs.

Simply Energy does not install advanced meters at customer premises to enable customers to choose non-flat tariffs. Instead, advanced meters are installed for the following principal reasons, all relating to regulatory requirements:

- new meter required due to change of connection characteristics (such as, an installation of solar PV);
- failure of an individual distribution network service provider (DNSP) meter, and;
- end-of-life notifications relating to DNSP meters.

Concluding remarks

In closing, Simply Energy looks forward to continuing to work actively with the AER to ensure that the methodology for the setting of DMO 3 accurately reflects forecast changes in the cost of supplying electricity retail customers.

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

James Barton
General Manager, Regulation
Simply Energy