

20 March 2019

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

By email: [DMO@aer.gov.au](mailto:DMO@aer.gov.au)

Dear Mr Feather,

### **Draft Determination: Default Market Offer Price**

Simply Energy welcomes the opportunity to provide feedback on the Australian Energy Regulator's (AER) Draft Determination on the Default Market Offer (DMO) Price.

Simply Energy is a leading second-tier energy retailer with over 680,000 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 actively supports open market competition and is committed to ensuring affordable energy services are available to all Australian energy consumers.

With this in mind, Simply Energy's submission evaluates:

- the AER's proposed methodology for setting the DMO price; and
- the benefits of establishing a predictable and consistent approach to setting the DMO price going forward.

### **Setting the DMO**

In setting its prices for the current determination period and into the future, Simply Energy would encourage the AER to be mindful of the intent of the DMO. As described in the Draft Determination Paper, the objective of the DMO is to:

*mitigate the impact of unjustifiably high prices for standing offer customers while allowing scope for continued competition in market offers.*<sup>1</sup>

The requirements under the National Energy Retail Rules around marketing on inflated base rates means that the DMO will in effect set a market price cap for a large portion of generally available market offers.<sup>2</sup> In light of this, Simply Energy is firmly of the view that the DMO should remain a safety net that provides retailers with sufficient headroom to provide their customers with competitive offers and value-added services.

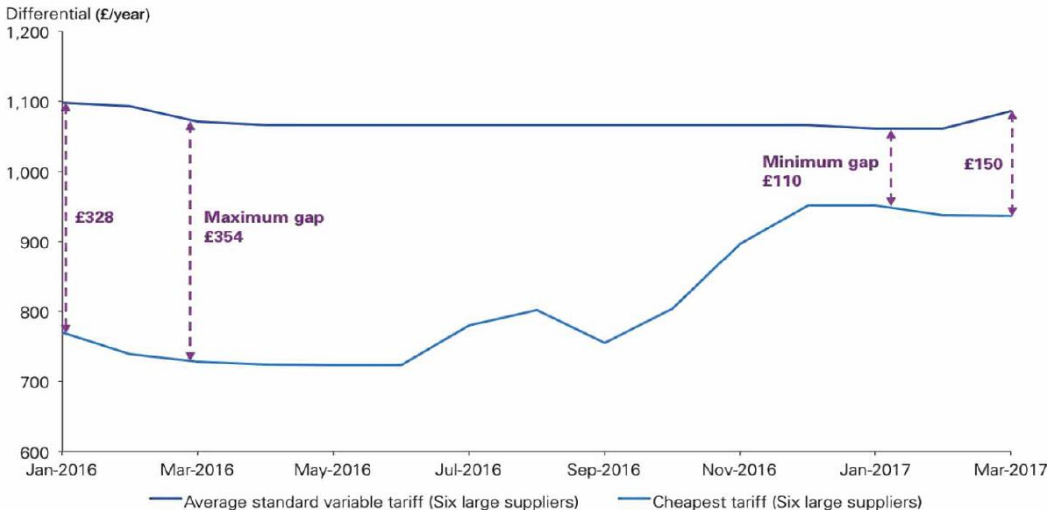
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<sup>1</sup> AER, *Draft Determination – Default Market Offer Price*, February 2019, 17.

<sup>2</sup> See NERR r 46B.

For a market to work there needs to be scope for customers to benefit from engaging with it. If headroom is less than a customer’s search and other transaction costs, then retailers will no longer be in a position to stimulate consumer engagement in the market. As a result, the market is at risk of stagnating. This is not in the long-term interests of consumers, as demonstrated by the United Kingdom’s recent experience with price re-regulation where the lowest cost offers in the market fell away.

**Market response to the announcement of price re-regulation in the UK**



Source: KPMG, What would a price cap mean for the UK?, June 2018, London, 5.

While some policy-makers and industry commentators have described electricity as a homogenous product, this is not entirely true, as electricity retailers provide differing service standards and complementary products to their customers. Simply Energy, for instance, has invested substantially in providing its smart-meter customers with an online tool to track their electricity usage. Simply Energy has also invested in the development of new product solutions to provide greater access to, and consumer benefits from, batteries, solar panels and other forms of distributed energy resources.

In saying that, much of the service and product innovation that is currently being implemented across the market is yet to provide commercially-proven returns. Retailers have, nevertheless, chosen to invest in service and product innovation to assist electricity customers lower their energy costs and ensure the long-term viability of Australia’s energy grid.

Simply Energy is, therefore, strongly of the view that electricity retailers should not be unreasonably constrained in the way that they price offers to the wider market. Unlike the market monitoring proposed in the Draft Determination Paper, Simply Energy considers that there should not be any further restrictions on how retailers price their offers to the wider market.<sup>3</sup> Simply Energy believes that this flexibility is imperative to ensure offer innovation is not stifled. In addition to this, Simply Energy considers that it is also important that any future adjustments to the DMO price are transparent, predictable and consistent.

**Benefits of a consistent and predicible price setting approach**

Simply Energy considers that greater levels of pricing predictability can be achieved through indexing the DMO prices based on observable market trends. This approach would ensure that the current level of headroom above prevailing median market offer prices is maintained. Undertaking such an approach would also take away the inherent unpredictability and risk associated with developing a regulated cost-stack that is likely to be based on assumptions that may not necessarily reflect prevailing market conditions.

<sup>3</sup> Cf AER, above n 1, 10.

That said, market trends used for adjusting the DMO price would need to be based on sustained and justifiable data that has been consulted on with industry stakeholders. One only needs to look at the wholesale cost assumptions considered in the Draft Determination Paper which are based on figures from back in October 2018. These figures do not take into account the higher forward cost curve as a result of recent weather events and, as such, relying on these assumptions could lead to retailer costs being understated.

Further, Simply Energy does not accept the AER's view that prevailing market prices could be influenced by 'retailers' strategic behaviour in response to the proposed pricing approach.<sup>4</sup> Distorting market pricing in the manner suggested would be commercially unviable in the long-term. Indeed, electricity retailers operating in competitive markets are continually looking at how to increase their market share to expand their revenue margins in line with their individual service capacity. Any retailers trying to artificially inflate median market offers will leave themselves exposed to customer churn.

The increased level of pricing transparency and information provided to customers means that customers are likely to transfer to another retailer if their current retailer is not offering competitive prices. It is acknowledged that some retailers could attempt to mirror each other's prices based on publicly available information to force up median electricity prices. However, such a strategy would not be sustainable in the long-term, as one or more market participants would take the opportunity to undercut the high retail prices in order to increase their own market share. This is simply a natural function of a competitive market.

It is ultimately this self-regulating behaviour of a competitive market that means that the median market offer in each distribution supply area should always act as a minimal baseline for determining the adequacy of the prices set under the DMO. Indeed, ensuring that prices are set in this manner is consistent with the Australian Competition and Consumer Commission's recommended approach which observed that:

*[t]he default offer is, in a sense, a premium offer with additional safeguard features that come at a cost. This will result in a price that is higher than the lowest priced offers in the market...<sup>5</sup>*

## Concluding remarks

In closing, Simply Energy would like to emphasise that any regulated default offer will always be an estimate, and as such imperfect. Simply Energy, therefore, encourages the AER to continue to use the median of market offers plus additional headroom as the basis for setting the DMO.

As a leading Australian energy retailer, Simply Energy ultimately sees itself as having a shared responsibility to working towards developing a market that meets the long-term interests of all energy consumers. For this reason, Simply Energy looks forward to continuing to work with the Australian Government and the AER in improving market outcomes for all consumers.

Simply Energy welcomes further discussion in relation to this submission. To arrange a discussion or if you have any questions please contact Anthony O'Connell, Senior Regulatory and Compliance Officer, on (03) 8807 5134 or at [Anthony.OConnell@simplyenergy.com.au](mailto:Anthony.OConnell@simplyenergy.com.au).

Yours sincerely



James Barton  
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Simply Energy

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<sup>4</sup> Ibid 39.

<sup>5</sup> ACCC, Retail Electricity Pricing Inquiry - Final Report, June 2018, 249.