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18 March 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– Draft Determination

Simply Energy welcomes the opportunity to provide feedback on the draft determination 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 the Australian Energy Regulator's (AER) draft determination, particularly relating to reductions in the headroom within the DMO price in 2021-22 and the implications this may have on the usefulness of the DMO as a reference price.

Retail costs related to the economic recession

Simply Energy does not support the AER's proposal to exclude the cost impacts of COVID-19 in the DMO 3 determination. As noted in the draft determination, the Australian economy has been impacted by COVID-19 and government decisions to reduce its transmission. It may take several years for the Australian economy to recover from the effects of COVID-19, with government forecasts indicating significantly higher levels of unemployment than in the years prior to the pandemic.[1] As outlined in its submission to the position paper, Simply Energy expects that higher levels of unemployment correlate with higher bad debt expenses for retailers.

Bad debt expenses are expected to increase in 2021

Bad debt expenses were higher than average in 2020 and Simply Energy expects this to worsen during 2021 as energy customers begin to face higher budgetary pressures due to the conclusion of various financial support programs introduced in 2020 (including support from governments and banks). Support programs are concluding at a time when the threat of COVID-19 appears to have largely subsided in Australia and the outlook appears relatively more predictable than in 2020.

[1] Reserve Bank of Australia 2021, Statement on Monetary Policy: Economic Outlook, February.

However, the experiences of 2020 and early-2021 have shown that the situation can change rapidly and economic activity can be significantly disrupted at short notice.

Simply Energy considers that retailers face a real risk of significant increases in bad debt expenses in 2021.

Without reflecting changes in retail costs, the DMO will be less useful as a reference price

If the AER does not reflect forecast increases in bad debt expenses in DMO 3, Simply Energy is concerned this may deteriorate the headroom in the DMO price. As inflation rates tend to have an inverse relationship with unemployment rates, the AER's CPI indexation approach will not capture the actual changes in the costs of providing an energy retail service when unemployment is high.

Simply Energy considers that the DMO has helped consumers to better understand and compare electricity offers amongst retailers. However, this benefit could be undermined if percentage discounts on electricity offers vary significantly over time due to regulatory decisions rather than market trends. For that reason, it is likely to be beneficial if headroom included in the DMO price continues to be maintained at a consistent level above competitive retail electricity offers to the extent possible. This would ensure that consumers that sign-up today can trust that their discount is comparable to those available in the market when they choose to engage with the market.

For example, a consumer may sign-up to an offer that is 20 per cent below the DMO in 2021. If the DMO does not move in line with actual retail cost changes, the offers available when the consumer next engages in the market may only be around 15 per cent below the DMO (even though these offers may actually cost less per month than the consumer's current contract). From a consumer's perspective, the available offers may initially appear to be less competitive than their current contract, which may reduce their incentives to engage in the market and switch retailers. Reducing clarity of the relative price of different energy offers may harm competition in the market as consumers become deterred from switching to offers that would lower their electricity bills and could effectively work against one of the reasons the DMO was introduced. As such, all things being equal the DMO should strive to provide consumers with a transparent and consistent benchmark that does not suppress retail cost-recovery.

The AER should use the step change framework to reflect significant and unexpected costs

Although the DMO is set at a level that means it will remain higher than retailers' efficient costs despite increases in bad debt expenses in 2021-22, the AER should not rely on this fact to dismiss adjusting DMO 3 for legitimate changes in retail costs.

Simply Energy proposes that the AER use its step change framework to reflect changes in retail costs that are not captured by CPI indexation. This should ensure that the DMO price remains at a consistent level above median market offers over time without the need to undertake a costly bottom-up assessment of retailers' efficient costs. In relation to the AER's criteria to consider an adjustment under the step change framework, Simply Energy considers that:

- COVID-19 has been a significant and unexpected event that has altered the operating environment for all retailers
- The increased bad debt expenses arising from the economic downturn are not compensated in other parts of the DMO methodology – the CPI indexation approach does not capture the impacts on retailers' costs from increasing unemployment levels
- Publicly available information estimates that bad debt expenses increased by between $4 to $10 per customer in 2020-21. As noted above, Simply Energy expects that the industry will face higher bad debt expenses in 2021 than in 2020.

For the future DMO methodology review, Simply Energy considers that the AER's methodology for residual cost changes should combine CPI indexation with additional measures that estimate other drivers of retail cost changes. This would reduce the need to rely on the step change framework to capture unexpected cost changes that are not compensated elsewhere in the DMO methodology. For example, the AER could estimate changes in bad debt expenses in line with credible forecasts such as movements in the unemployment rate.

Installation of advanced meters will become a more significant cost for retailers over time

The installation of advanced meters is a real cost incurred by retailers, which will become more significant as the uptake of advanced meters becomes more significant in the coming years. If retailers are asked to absorb these costs solely through their competitive market offers, this will likely further reduce the headroom in the DMO price and reduce the level of discounts available in the market. Simply Energy proposes that the AER consider including an allowance for advanced metering costs through the step change framework until an ongoing methodology can be determined in the upcoming DMO methodology review.

Other aspects of the draft determination

Productivity factor

Simply Energy supports the AER's draft proposal to not include a productivity factor in the DMO methodology. Simply Energy agrees with the AER that a productivity factor should only be considered if the AER were to use a more representative estimate of retail costs in the DMO price determinations.

As noted previously, Simply Energy considers that the DMO should broadly follow changes in the costs of providing retail energy services so that the headroom within the DMO remains at a broadly consistent level over time. Rather than undertaking a bottom-up assessment of retail costs and implementing a productivity factor, the AER could instead occasionally rebase the DMO cost stack if the DMO price becomes too high or too low relative to median market offers.

Usage profile for time-of-use tariffs

Simply Energy supports the AER's draft proposal to update the time-of-use usage profiles for more recent data while retaining the simplicity of a one-day usage profile. As noted in its submission to the position paper, Simply Energy considers that introducing a more granular usage profile would not significantly improve consumers' ability to compare the relative price of offers amongst retailers.

Concluding remarks

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
General Manager, Regulation
Simply Energy