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6 April 2023

Stephanie Jolly
General Manager – Market Performance
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Dear Stephanie Jolly,

Re: Default Market Offer 2023-24 – draft determination

Simply Energy welcomes the opportunity to provide feedback on the Australian Energy Regulator's (AER) draft determination on the Default Market Offer price for 2023-24 (DMO 5).

Simply Energy is a leading energy retailer 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.

Simply Energy acknowledges that the proposed DMO price increases in the draft determination are significant and will be challenging for some small customers to afford at a time they are also facing broader cost-of-living pressure. The increase in wholesale costs over the past year have also created difficulties for energy retailers, and we also expect that higher retail electricity prices will lead to more missed bills and add to bad debt costs carried by retailers at a time where margins are already at historically low levels.

We are broadly comfortable with the wholesale cost methodology

Simply Energy supports the AER's proposal to not make large-scale changes to the current wholesale cost methodology. We maintain our view that the AER could refine and improve its methodology by adopting more risk averse settings and forecasts in its wholesale cost methodology. This would ensure that the DMO is set at a level that maintains retailers' financial viability while also providing fallback protection for customers from excessively high prices.

We support further assessment of load profiles

While Simply Energy understands the AER's reasoning for maintaining its current load profile approach for DMO 5, we do note that this approach excludes the relatively more variable load of solar PV customers, which is a customer group that is continuing to grow significantly each year.

We are pleased that the AER has committed to undertake further testing in 2023 on whether a load profile can be developed based on both basic meters and smart meters with solar PV systems. Simply Energy would support the reliance on the combined load profile in DMO 6 if there is sufficient evidence that it would significantly improve the accuracy of wholesale cost forecasts.

The margin for forecast error should be set in a risk-averse manner

Simply Energy does not support the AER's draft decision to maintain its approach to modelling price outcomes using the 75th percentile estimate rather than the 95th percentile estimate. During the DMO 4 consultation, we did not support the AER adopting less risk averse settings while the market was entering a period of higher volatility (due to the acceleration of the energy market transition and the risks of international volatility affecting the Australian market). We were particularly concerned that this change may have been implicitly signalling to retailers that they should be less risk averse in their approach to hedging against wholesale price exposure.

In the context of market events since DMO 4, we maintain our view that there is a strong case to reconsider this decision and reinstate the more risk averse settings that were in place prior to DMO 4.

We do not agree with the AER's view in the draft determination that the use of the 95th percentile would unfairly burden consumers due to a higher wholesale cost estimate. This is because the DMO is a price cap on standing offer prices and does not impose any prices or specific costs onto consumers' electricity bills. Our view is that the DMO should be set in a risk averse manner that ensures that, even when extreme circumstances eventuate, retailers can recover the efficient costs of providing services while also ensuring that standing offer prices are not set at unjustifiably high levels above market offer prices.

It is reasonable to include unknown market compensation costs in future DMO determinations

Simply Energy is comfortable with the AER's draft decision to only include known compensation costs in the wholesale cost component of DMO 5. We expect the AER to include subsequent compensation costs in future DMO periods when those payment amounts become known.

The current retail cost methodology should remain in place

As noted in our submission to the AER's DMO 4 draft determination[1], we did not support the AER's proposal to adopt a bottom-up cost methodology. However, as the AER made this methodological change in DMO 4, we are supportive of the new methodology continuing until the AER next undertakes a future broad review into the DMO methodology.

In relation to bad debt costs, while there are clearly benefits from the transparency of relying on publicly reported information on bad debt costs, our key concern is the time lag in the data. Simply Energy does not agree that publicly reported bad debt expenses in 2020-21 are representative of the bad debt expenses that will likely be incurred by retailers in 2023-24. An alternative option could be for the AER to assess the ratio of bad debt to revenue in the years that data is available and apply that percentage in its DMO 5 estimate.

If the AER retains its approach to bad debt costs, we would urge the AER to apply CPI to bad debt costs to retain their value in real terms across the DMO 5 period, which would align with the AER's approach to other retail operating costs.

The retail allowance glidepath should either continue or be paused for all customers

The retail allowance is not currently transparent and is difficult to assess

Simply Energy reiterates its view that the AER's approach to estimating the retail allowance is not transparent or objective and this makes it challenging to assess whether it is set an appropriate level. In order to transparently estimate the retail allowance, the key questions that arise are; what

[1] Simply Energy 2022, Submission to Default Market Offer 2022-23 – Draft determination, 10 March, p. 2.

are the components of the retail allowance and what are the reasonable values for those components? Simply Energy considers that a retail allowance should include:

- An estimate of the sustainable retail margin in the competitive electricity retail market;
- A component that represents the headroom of the DMO and provides incentives for innovation and consumer engagement in the market; and
- An uplift to cover the risk of forecast errors that are not included elsewhere in the cost stack (for example, risks that the ACCC cost data underestimates actual retail costs, risks that lagged bad debt costs are inaccurate, and any other forecasting risks introduced through the wholesale cost methodology).

We support the retention of a percentage-based allowance

Despite our concerns with the opaqueness of the retail allowance, Simply Energy supports the AER's draft decision to continue to apply the retail allowance as a percentage of total costs.

As we noted in our submission to the issues paper, we consider it is appropriate that the allowance is relatively higher in real terms when electricity prices are increasing and relatively lower in real terms when electricity prices are decreasing. For example, in a high price environment, we consider it is appropriate that the retail allowance retain a higher uplift to reflect the risk of forecast errors in bad debt costs and the necessary working capital buffer that retailers require to ensure they can continue to meet their obligations in the market.

We accept that it may be reasonable to pause the retail allowance glidepath due to the current uncertain market conditions. However, we do not agree that it would be reasonable to only pause the glidepath for those customers that would incur a higher DMO price due to the continuation of the glidepath. While the AER had an understandable methodological basis for introducing the glidepath, we do not believe that the proposed pause for specific customers has any justification beyond a deferral in price increases to future periods. Simply Energy urges the AER to either pause the retail allowance glidepath for all customers in DMO 5, or to continue with the glidepath for all relevant customer cohorts as originally envisaged.

Concluding remarks

Simply Energy looks forward to working actively with the AER to ensure that the DMO 5 determination 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