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BY EMAIL

To Department of Environment, Land, Water and Planning
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Copy The Hon. Lily D'Ambrosio MP
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Dear colleagues

amaysim submission on Consultation Paper on Victorian Default Offer - Draft Orders

1 Introduction

This submission relates to:

- the Department of Environment, Land, Water and Planning (**DELWP**) consultation paper seeking stakeholder views on draft Orders in Council to implement the Victorian Default Offer (**VDO**) (the **Consultation Paper**); and
- the draft Order in Council, regulating tariffs for the sale of electricity to prescribed customers, to be made under section 13 of the Electricity Industry Act 2000 (EIA) (the **section 13 Order**) at Appendix A of the Consultation Paper.

amaysim is a large tier two energy retailer offering innovative products in competition with the major energy retailers (including gentailers). We aspire to be Australia's best customer-focused utilities service provider. Accordingly, we support all regulatory changes that produce long-term, sustainable benefits for consumers.

On 4 April 2019, we made detailed submissions to the Essential Services Commission (**ESC**) on the VDO more generally, setting out what we consider to be constructive suggestions (together with our reasons for them) for improvements to the VDO to make it fairer and more effective for consumers and industry.

In our submission to the ESC, we wrote that we believe the VDO will reduce prices for some Victorian customers in the short term. However, we are concerned that the VDO, in the form currently proposed, will lead to less competition, worse customer experience and higher wholesale prices or a distorted wholesale market in the future. This is compounded when one considers that the VDO is proposed to go live at the same time as the "Best Offer" rules.

We have also expressed concerns to the ESC and the Government that the rush towards a 1 July start date for the VDO does not enable an orderly process with structural consequences

and will artificially suppress the underlying costs faced by small retailers, causing prices to rise in the medium to long-term.

amaysim stands by those submissions. In this submission, we have sought to provide our specific comments on the Consultation Paper and the section 13 Order rather than repeat our submissions to the ESC. However, there is naturally some cross-over with our submissions to the ESC.

For completeness, we note that we do not make any submissions in relation to the proposed order under section 35(3B) of the EIA.

We would be delighted to discuss this submission with you directly.

2 Our submissions on the Consultation Paper

2.1 Question 1: Is the objective in clause 3 of the draft section 13 Order clear and appropriate?

amaysim agrees that the objective in clause 3 sets out the Government's objective for the VDO, as per the Second Reading Speech. In principle, we support the objective itself but consider it would benefit from refinement to ensure that it does not have unintended consequences.

To improve the appropriateness and clarity of the objective, we recommend that the objective should be re-worded along the following lines:

"The objective of the Victorian default offer is to provide a simple, ~~and trusted and reasonably priced~~ electricity option which is priced at a fair, reasonable and commercially viable level that safeguards consumers unable or unwilling to engage in the electricity retail market, while:

(a) promoting innovation and competition in the long-term interests of Victorian consumers; and

(b) preserving the benefits available to Victorian consumers who are able and/or willing to engage in the electricity retail market."

We explain these recommendations below.

- **New sub-paragraph (a)**

As per our submission to the ESC, we are concerned that the VDO may have the unintended effect of lessening competition in the Victorian electricity market and stifling product innovation which would otherwise meet the Government's objective of encouraging "simple" energy products.

In summary, we submitted to the ESC that:

- the VDO would exacerbate the difficulty that tier two retailers face in competing with the "big three" gentailers. This is because the VDO cost-stack is inappropriate for tier two retailers who are price-takers in the wholesale market and rely on often vertically integrated generators to supply them with hedges. The VDO in its current form and absent other reforms may distort the electricity market in the medium and long-term by causing a number of tier two retailers

to exit the Victorian market, ultimately lessening competition. Several other submissions to the ESC, including the ACCC's submission, identified concerns about the implications for competition and the long-term interests of consumers;¹ and

- o the VDO, by imposing a regulated operating cost structure, effectively disincentivises retailers from any further investment in customer service or other innovative features which would improve customer experience and hopefully encourage product simplicity. The ACCC also expressed concerns about the effects on non-price competition and innovation in its submission.² We believe our new subscription energy product available in Victoria (<https://www.amaysim.com.au/energy>) is a good example of the type of innovation which the Government should be promoting rather than discouraging. We have invested significantly in the creation, development, testing and release of this new product which has simplicity as its core value – consistent and transparent pricing, no tricks, no hidden costs and no pre-planned price hikes. In fact, our tag line is “shockingly simple energy”.

amaysim submits that a simple, trusted and reasonably priced electricity offer should not come at the total cost of innovation or competition and this is what our amendments seek to address (in language which is in keeping with the objective of the ESC to promote the long-term interests of Victorian consumers). There is a need to balance the two, and our experience in the mobile industry has shown that innovation and competition promote good outcomes for consumers, trust in retailers and product simplicity in the long-term.

- **New sub-paragraph (b)**

In its submission to the ESC, the ACCC observed that “individual customers that were shopping around and benefiting from retail competition may disengage and end up paying a higher amount under a VDO ... If consumers are encouraged to ask their retailer to be placed onto the VDO, this risks consumers missing out on better offers that are available in the market ... Competition could be dampened if there is a smaller pool of engaged customers for retailers to compete for.”³

amaysim echoes the ACCC's concerns. amaysim agrees that there are likely customers who are “unable or unwilling” to engage in the market but notes that this is the minority and not the majority of customers. In fact, ACCC data shows that in 2017, just over 5% of Victorian residential non-solar customers were on standing offers.⁴ The ACCC also states that in recommending a default offer in the Retail Electricity Pricing Inquiry (REPI), it envisaged that it should only be used by a “small number of customers”.⁵

¹ ACCC submission to Victorian Default Offer to apply from 1 July 2019 - draft advice (ACCC Submission), page 2.

² Ibid.

³ Ibid.

⁴ Australian Competition and Consumer Commission, (Restoring electricity affordability and Australia's competitive advantage), Retail Electricity Pricing Inquiry – Final Report, June 2018 (ACCC Report), page 25 at Figure 1.25.

⁵ ACCC Submission, page 2.

amaysim submits that those customers who are in fact willing and/or able to engage in the electricity retail market should not be worse off as a result of the VDO. This is what this amendment seeks to ensure. Again, there is a need for a balance between protecting a relatively small (but nonetheless important) number of disengaged customers and ensuring that, to use the ACCC's words, "the large number of current customers who are beneficiaries of competition" are not "worse off".⁶

- **Additional pricing descriptors: "fair" and "commercially viable"**

amaysim notes that the Second Reading Speech and the ESC's Terms of Reference both point to the VDO needing to produce a "fair" price. We interpret this as being fair for both consumers and industry (the Terms of Reference refer to a "level playing field"), as a regulated price is inherently unfair if it is not fair for both the provider and consumer of the service. We believe that this is an important phrase that the Government has used in advocating for the VDO which has been omitted from the objective.

amaysim acknowledges that retail prices and margins of some energy retailers may be above the Government's expectations and some international benchmarks. However, the unique geographical layout of the NEM, concentration of most generating assets within a few gentailers, vast transmission distances and volatile weather patterns (which further exacerbate average versus peak usage) all contribute to Australian energy costs which are higher and more difficult to manage, comparatively, to those in other international markets. Against this backdrop, industry still makes energy services available to consumers. It cannot be expected to do so if it is not commercially viable. Our amendment seeks to clarify that the Government does not intend to make the retail price of electricity commercially unviable, as this may affect the quality and reliability of electricity which is at odds with the ESC's mandate to have regard to the quality and reliability of essential services.⁷

2.2 Question 2: Does Clause 6 of the draft section 13 Order adequately give effect to the VDO for the initial period from 1 July 2019 to 31 December 2019?

amaysim accepts that the VDO, in the form proposed by the ESC in its Draft Advice, will provide a short-term price reduction for Victorian customers on standing offers. In the sense that clause 6 seeks to enshrine the ESC's Draft Advice into fixed tariffs per distribution zone during the initial period from 1 July to 31 December 2019, we consider that it "gives effect to the VDO".

amaysim notes that the Consultation Paper suggests that consumers who are not on standing offers comprising a flat tariff or a flat tariff with a controlled load will be able to "opt in" to the VDO. However, we are unclear as to where this right exists in the draft section 13 Order and consider that this comment and/or the order itself would benefit from clarification in this regard.

While this six-month initial period is relatively short, we submit that the impact of the VDO, if implemented in the form proposed by the ESC in its Draft Advice, will have a lasting impact on the Victorian energy market. To this end, we encourage the DELWP to consider the various submissions made to the ESC on the VDO which highlight some of the long-term

⁶ Ibid.

⁷ Essential Services Commission Act 2001 (Vic), section 8.

detrimental impacts to the Victorian energy market as a result of the implementation of the VDO in its current form.

In particular, we note the ACCC's concerns that the VDO is likely to result in decreased competition, disengaged customers and as a result "some retailers, especially those that have unconventional or innovative retail offerings ... may find the Victorian market less desirable to enter."⁸

amaysim supports the ACCC's summary of the likely impact of the VDO (as currently proposed) on the Victorian energy market. With a compression of retail margins, we submit that the VDO ultimately will create long-term structural barrier to entry for new participants, resulting not only in a reduction in innovation and competition, but also a consolidation and dominance in the industry of the incumbent retailers and gentailers as smaller retailers exit the market unable to compete and operate profitably. To this end, we consider that the cost-stack proposed under the VDO take into consideration the different operating models and cost structures of gentailers and asset-light tier two retailers.

2.3 Question 3: Does clause 9 of the draft section 13 Order appropriately reflect the objective of the VDO?

Subject to our comments on questions 1 and 2, amaysim accepts that the objective of the VDO may be achieved by the ESC determining prices for the VDO.

In respect of sub-paragraph (a), amaysim also accepts that 42 days is likely to be adequate given this applies where the ESC is simply setting a price (or price cap). amaysim also accepts that there is some benefit in ensuring that the implementation period is not overly long to ensure that the most current data is used by the ESC in arriving at its determination. That being said, it would be helpful if the ESC also provided an interim, non-binding, draft at 90 days prior to implementation to allow retailers time to review and ready business processes.

However, if we are interpreting sub-paragraph (b) correctly, we believe that the same 42 day period would also apply where a price (or price cap) is not simply being set, but instead, a method for determining which price the retailer may charge under a standing offer is set. In other words, the ESC would determine a method by which retailers could legally price their standing offers (rather than setting a price). If we have misinterpreted sub-paragraph (b), then we suggest that this section should be clarified as others may misinterpret it too.

In this case, amaysim submits that a 42-day lead time is likely to be insufficient for retailers to review, interpret and implement this new method. Accordingly, we consider that a 90-day period should apply to sub-paragraph (b). This timeframe would increase transparency of the process by allowing time for consultation and discussion with the ESC regarding implementation, prepare business processes, design new products, and configure and test billing systems.

From a drafting perspective, we also consider that it would be beneficial to clarify whether the references in clause 6 to "tariffs a retailer may charge" and the references in clause 9 to "prices, or the maximum prices, a retailer may charge" is deliberate. If we are interpreting these clauses correctly, it appears that during the interim period there will be a set price (not a cap) whereas the during subsequent regulatory periods, there may either be a set price, a

⁸ ACCC Submission, page 2.

cap or a method for determining or calculating the price or cap applicable to the specific retailer.

2.4 Question 4: What would be the implications of the alternative option – the VDO continuing to be a flat tariff (or flat tariff with controlled load tariff) only?

amaysim does not make any submissions in relation to this question.

2.5 Question 5: Does the approach and methodology specified in clause 11 of the draft section 13 Order appropriately reflect the objective of the VDO?

As mentioned above, amaysim considers that the objective of the VDO needs to be refined to ensure competition and innovation are not stifled, engaged customers are not disadvantaged by the VDO, and the VDO price is also fair and commercially viable.

That being said, we consider that the approach and methodology specified in clause 11 indeed goes some of the way to reflecting the objective of the VDO (even subject to the amendments we suggest above) and generally covers the components of the "cost stack", with some general and more specific caveats.

The general caveats are that the VDO cost methodologies proposed by the ESC in its Draft Advice are generally biased towards major retailers and do not allow or encourage innovative product offerings. amaysim submits that a general interpretation provision should be included in clause 11 which requires the ESC to reverse out any inherent major retailer or gentailer bias and a further limb should be included in sub-clause (4) which makes an allowance for the reasonable costs of innovation.

Set out below are some specific caveats on various elements of the cost stack:

Sub-clause 3 We submit that the reference to "efficient costs of a retailer" is an unusual phrase (typically, a retailer itself would be efficient, rather than its costs). The phrase also leaves open whether this is a subjective or objective test. We also note that retail operating margin is not a "cost" to a retailer. amaysim submits that this phrase might be better expressed as "based on the costs of a reasonably efficient retailer, earning a retail operating margin consistent with the principles set out in sub-clause 6 below".

Sub-clause 4 amaysim makes the following submissions in relation to the cost-stack set out in sub-clause 4:

Paragraph (a) Wholesale costs

amaysim submits that further clarification in relation to the wholesale cost line of the cost stack is required, in much the same way that the draft section 13 Order provides further in clarity in relation to customer acquisition and retention costs and retail operating margins. This is because one size does not fit all when it comes to wholesale costs. Pure retailers, such as amaysim, do not have any generating capacity, relying instead on generators and other counterparties to hedge (typically using load following hedges) their exposure to spot market volatility. This makes pure retailers "price takers", with very limited scope to control wholesale costs. Our current wholesale costs are locked in for at least

twelve months ahead, so our ability to change them in response to the VDO is essentially non-existent. This is an important point of difference between tier two retailers and the major energy retailers (i.e. the gentailers).

We submitted to the ESC that its proposed cost-methodology is heavily weighted to a substantial and mature generator profile, and often supported by management of wholesale costs. This cost-methodology bias does not consider the "efficient costs of a [tier two] retailer". To this end, amaysim submits that the section 13 Orders should specify a clear methodology for calculating wholesale costs which:

- is transparent and replicable by retailers. In particular, we strongly recommended that the draft section 13 Order specifies formula, based on multiples of observable futures prices (rather than spot prices), for the calculation of wholesale costs. This will enable all participants to quickly and easily determine the VDO price that would apply in future periods, and be able to plan and manage their commercial operations more effectively (to reduce risk). This is a feature of the GloBird submission which we broadly support;⁹
- expressly allows for a greater level of wholesale costs than was proposed by ESC in its Draft Advice, to reflect the additional wholesale costs which non-gentailer retailers incur (e.g. by hedging) and the costs of wholesale risk management (including, in particular, the cost of capital allocated to meeting prudential and credit support requirements); and
- specifies that ESC must have regard to the most current available load data (being all relevant pricing data up to the date of the relevant VDO calculation or as near as possible).

Paragraph (d) Retail operating costs

Similarly, amaysim submits that the draft section 13 Orders should provide greater clarity to the ESC on the appropriate cost methodology for retail operating costs. In particular, the VDO cost methodologies should consider and allow for:

- more retail operating costs, in particular an allowance be included for the purchase of non-current assets (ie the purchase of capital assets) and a larger allowance generally for retail operating costs to reflect significant cost increases in the 2018/19 financial year. In particular, we note that the proposed retail operating costs set out in the ESC Draft Advice is based on the ACCC's REPI analysis which finishes at 2017/18. amaysim and other market participants have seen significant increases in costs in the 2018/19 financial year, in particular in the area of bad debts. The section 13 Orders should also specifically provide an allowance for the purchase of non-current assets via an allowance for depreciation and amortisation. Importantly, depreciation and amortisation can be reliably measured

⁹ Public forum GloBird Energy presentation slides, 25 March 2019 available at: <https://www.esc.vic.gov.au/sites/default/files/documents/VDO%20-%20Draft%20advice%20-%20public%20forum%20presentation%20-%20GloBird%20Energy%20-%2020190325.pdf>.

and substantiated, given the application of applicable accounting standards and most energy retailers, if not all, have depreciation and amortisation audited in preparing financial statements; and

- "reasonable (having regard to all of the circumstances, including the different circumstances faced by retailers of varying scale)" rather than "modest" customer acquisition or retention costs. We note that the various limbs of sub-paragraph (5) talk in terms of "reasonableness" and being "not excessive" rather than "modesty", which is inherently small or limited whether or not it is reasonable in the circumstances. We highlight that smaller retailers often have more "activities that give rise to costs" such as costs to acquire customers or invest more in customer service, as compared to the large retailers who have the full benefit of a long investment in brand and services due to time-in-market and scale. These additional costs are "not unnecessarily incurred" and are a reasonable expense in the smaller retailer business model to maintain sustainability. Failure to account for these reasonable costs will force retailers to shift their focus away from innovative solutions and investment in the industry and customer service. These are the first "activities that give rise to costs" that will be cut as retailers attempt to align with the VDO price. To this end, we encourage the DELWP to provide leniency for additional investment in innovation and customer service in its assessment of the VDO cost methodology.

Paragraph (e) Retail operating margin

We submit that for the purposes of this subsection and sub-clause 6, in determining the "maximum retail operating margin" a retailer may earn, the reference to what is "reasonable in all the circumstances" should include the fact that the electricity market includes both large gentailers who might be encouraged by the VDO to simply shift forgone retail margin into their wholesale book and have the benefit of very strong balance sheets, cashflows, sticky customer bases and sophisticated support infrastructure, and smaller tier two retailers who already struggle to compete with the larger retailers and gentailers but are nonetheless vital to ensuring the major energy retailers are not able to utilise their market dominance to the detriment of consumers. We suggest this could be done by adding these underlined words: "reasonable in all the circumstances, including the different circumstances faced by retailers of varying scale".

2.6 Question 6: Are there any other matters the ESC should be required to consider in setting prices for the VDO?

We submit that subscription pricing constructs should be expressly recognised as "other types of tariffs" for the purpose of tariff categorisation, as subscription pricing (such as the pricing offered by amaysim to Victorian customers) does not adopt either a flat tariff or flat tariff with a controlled load tariff.

We also reiterate the submission that we made to the ESC that subscription pricing should be excluded from the "Best Offer" rules for the following reasons:

- the Best Offer rule should only apply to comparable typical market construct energy products which simply take per-unit usage and price into account in determining the bill amount; and
- subscription based products rely on investment in customer experience and value-added features which, in other markets such as telecommunications, are considered consumer benefits but which, under the VDO, would be compared to basic products which lack these benefits.

VDO pricing and the Best Offer rules cannot be viewed in isolation.

2.7 Question 7: Will this approach assist customers to access the VDO? Or would it be preferable to prescribe the wording on bills and if so, what should this wording be?

amaysim supports the proposed approach to give retailers discretion in relation to the wording used on bills to inform customers on how they can access the VDO.

Prescriptive wording, when used on a mass scale across retailers of all sizes, has the potential to cause customer confusion as retailers are unable to tailor bills to cater for different customers and product offerings. The other issue with prescriptive wording is that consumers are likely to, over time, ignore the words as it they become standard boilerplate. Instead, it needs to evolve to suit the circumstances and the tone of each brand.

2.8 Question 8: Are there any implementation issues that should be considered?

Yes. The implementation of the VDO will require:

- significant training of all retailer employees, particularly customer service staff (which for many retailers including amaysim are located overseas). This requires significant time and resources in the current regulatory climate which will, come 1 July, see the introduction of not only the VDO but also the new Victoria Best Offer rules and the new Default Market Offer rule (for NSW, SA and QLD states). Having differing approaches for differing governing bodies creates complexity and confusion for operational staff and customers and requires thorough training and education throughout the business at all levels; and
- significant system changes to cater for the construct of the VDO, including stepping of rates depending on the Distributor region. This will impact on time and cost to implement. The complexity of the VDO construct also adds to operational training times and the additional support required post implementation.

Moreover, as with any operational change, there are always unforeseen implementation issues that arise and need to be revised and corrected throughout a transition period. We also submit that operating within multiple and different regulatory regimes across a country with a relatively small population is not efficient and adds costs which are ultimately borne by consumers.

For this, and the reasons stated above (see section 2.3), we submit that an increased lead-time from VDO price release to implementation should be adopted.

2.9 Question 9: Will the approach proposed in clauses 14 and 15 adequately meet the Government's intention to enable discounted offers to be easily compared?

amaysim respectfully submits that clause 14, as currently drafted, is complicated and would benefit from further clarity on several points. The key areas which we consider would benefit from refinement and consideration are as follows:

- **Existing vs prospective customers:** No distinction is made under the proposed orders between existing and prospective customers, although it is implied by the word "gives" towards the start of paragraph 2 that the rules will apply to existing customers. The section would generally benefit from clarification as to the extent to which it applies to existing customers. For example, are the words "disclose, prior to an offer being accepted or the commencement of a discount being given" in sub-paragraph (c) intended to apply to prospective customers only?
- **Location of disclosure:** If clause 14 applies to existing customers, we consider that the clause would benefit from increased clarity about where disclosure should be made, given that sub-clause 8 only mentions "advertising" which is unlikely to apply to existing customers. Further, the word "advertising" is extremely broad, and we are concerned that it may not be possible to make the full disclosures contemplated by sub-clause (2) given their inherent breadth as drafted in all advertising mediums (such as social media tiles and banners). amaysim submits that, like the Telecommunications Consumer Protection Code,¹⁰ a lower standard of disclosure should apply in "small online advertising" such as strip, banner or tile advertising (or other equivalents).
- **Price reductions:** For clarity, we submit that the amount of the "price reduction" to be disclosed should always be the greater of zero and the relevant price reduction (if any), so that the discount as against the VDO is expressed as either \$0 or a positive amount (and not a negative amount, which may confuse consumers).
- **Disclosure of calculation:** It is currently unclear what a retailer should disclose in order to comply with the requirements in clauses 14(1)(a) and (b) to disclose "how a discount is calculated". amaysim submits that this would benefit from further clarity and an example of the level of detail required. For example, would it be sufficient to say that the discount has been calculated in accordance with the section 13 Order?
- **Expression:** We note that the ACCC has been actively discouraging calculators or predictive tools on energy retailers' websites which purport to represent potential savings over a period or by comparison to other plans or products based on estimated usage. The risk is that customers come to expect (and are ultimately misled) that they will achieve a specific dollar amount of savings. This is compounded by both the interplay with the "Best Offer" rules and the fact that the VDO price will change over time. Accordingly, we consider that a percentage base discount rather than a dollar-based discount, is in most instances, preferable.

¹⁰ https://www.acma.gov.au/-/media/Networks/Regulation/pdf/TCP_code_C628_2015_incorp_Variation_No1_2018-pdf.pdf?la=en; see definition of "small online advertising" and specifically section 4.2.6.

2.10 Question 10: Is the proposed method for determining the estimated annual cost of offers in Schedule 3 simple and easy to use?

amaysim does not make any submissions in relation to this question.

2.11 Question 11: Is the proposed review period and approach appropriate?

amaysim believes that the VDO will reduce prices for some Victorian customers in the short term. However, for the reasons set out in this submission and in our submission to the ESC, we are concerned that VDO, in the form currently proposed, will lead to less competition, worse customer experience and higher wholesale prices or a distorted wholesale market in the future.

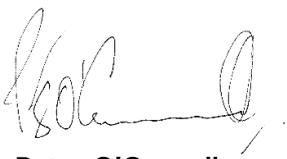
Accordingly, we suggest that a review period be initiated prior to the 1 January 2021 regulatory period to ensure the VDO is achieving the objectives stated. This will provide an opportunity to correct underlying issues with the VDO before substantial damage may be done to the industry.

3 Conclusion

amaysim supports the wider policy objectives of the VDO and asks DELWP to consider this submission with an open and constructive mind. However, given the complexity and importance of the matters raised by amaysim and others to both the Government, the ESC and DELWP, we strongly recommend that the current timeline for implementation of the VDO should be delayed to ensure that Victorians benefit in both the short and long-term from thoughtful and considered regulation.

We would welcome the opportunity to discuss our recommendations with you. Please contact our Chief Strategy Officer, Alexander Feldman [REDACTED] or Chief Executive Officer, Peter O'Connell [REDACTED] should you wish to do so.

Yours faithfully



Peter O'Connell
Chief Executive Officer



Alexander Feldman
Chief Strategy Officer & General Counsel