

GloBird - Positive Energy

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Building 10, 613 Maroondah Hwy, Mitcham, VIC 3132



Dept of Environment, Land, Water and Planning (DELWP)

222 Lonsdale Street, Melbourne Vic 3000

Dear DELWP,

The Department of Environment, Land, Water and Planning have released a consultation paper draft on the "Victorian Default Offer". I would like to provide this submission to the Department to express our deep concerns about the Victorian Default Offer and the way it is being set.

We see several issues in the current way of VDO being set:

- 1) The Wholesale Energy Cost model being used is theoretical, impractical, lacks transparency and is at least 15% lower than the actual cost.
- 2) There is no consideration or allocation to encourage customer engagement in the market.
- 3) The VDO does not include the license fees charged by the government to a retailer
- 4) The allowance for investment return is below a reasonable investors' expectation.

The purpose of the VDO is to offer a fair price to disengaged Victorian small customers. However, if set at a level that is unsustainable for the industry, it will deliver exactly the opposite result.

Based on the Victoria Energy Market Report 2017-18 released by ESC in Feb 2019, only 6% of customers are on standing offers and paying a "loyalty tax", the vast majority are with the big 3 retailers. On the other hand, 42% of small customers are with small and medium retailers, and based on the same ESC report, all the lower market offers are provided by small and medium sized retailers. In fact, there is a further 30% savings available compared to the best market offers from the big retailers, and it's important to note that all market offers are lower than standing offers.

It's key to remember that the number of customers who are active in the market are not the 6%, but the majority. This is a sign that competition in the retail sector is working. While we acknowledge some aspects of retailer market practice could be improved, it is dangerous to draw a conclusion that competition is bad, and that consumers will be better off without it.

A market without adequate competition has never delivered long term benefit to consumers. Based on the ACCC's report, there is a lack of competition in the wholesale market, "[Market concentration in the NEM has recently increased, through both acquisitions and closures of significant assets \(figure C\). Where markets are concentrated this can significantly affect bidding behaviour dramatically and lead to prices above efficient levels. The tightening of supply and demand, brought about mainly by the exit of large coal-fired generators, has seen a general 'lift' in wholesale prices across the NEM in recent years.](#)"

This lack of competition in the wholesale market is obvious. The wholesale electricity spot price has increased from \$26.6/MWh in Q1 2015 to \$165.97/MWh in Q1 2019, a whopping **524% increase** in a matter of just 4 years. Unfortunately, governments have failed to recognise the wholesale price as the root cause of the problem. According to ESC commission Chair, Dr Ben-David, the "Victorian residential customers were on standing offers that had jumped in price by more than 20 per cent in the past two years", while the statement is true, generators have reaped the benefits and retailers have had to absorb the costs by reducing margins.

Setting the VDO price at an unattainably low level will first destroy small and medium retailers, leaving all customers with no choice but to accept the higher market offers from the big retailers, resulting in higher energy bills for over 42% of small customers. The government will be responsible for destroying competition, removing the most competitive offers from the market. Yet the underlying problem of wholesale prices will

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still be left unsolved. It is inevitable that the government will eventually be forced to price the VDO correctly which means the government will have to introduce an electricity price rise to the public.

The VDO is supposed to act as a default for disengaged customers and to replace standing offers and it will be referenced by all market offers, making it effectively a ceiling price for all market offers. It should not be the goal of the VDO to compete directly with the leanest offers on the market. It is simply there to protect disengaged customers from paying unreasonably high rates.

The terms of reference are to arrive at a VDO price that will deliver a “reasonably priced electricity offer without impeding the consumer benefits experienced by those who are active in the market.” To achieve this, there must remain a visible gap between the VDO and a market offer by a lean and efficient retailer that acts as an incentive for customers to engage in the market to prompt competition. Unfortunately, the calculation of the VDO does not do so. The result of a lower ceiling will inevitably discourage customer engagement, reduce competition, and ultimately remove the benefit currently experienced by active customers.

When setting the VDO price, it is important to remember we are only a retailer. We buy energy on the wholesale market, hedge risk, add a small margin, and arrive at our own retail price. Until the VDO, if wholesale prices go up, we could change our retail price accordingly. The VDO changes all this. It forces us to sell at a price not set by us.

GloBird Energy would be happy to sell power at any price deemed fair by the government, so long as the wholesale cost is also set by the government accordingly, which is not possible in today’s wholesale market environment. Therefore, it is important that when calculating the Wholesale Energy Cost (WEC) for the VDO, it should be calculated with the actual cost a retailer faces in the real world, plus some consideration to cater for the demand forecasting variance, unpredictable wholesale market movements, and the kind of non-optimal pricing that arises when a human being trades in the market without the benefit of knowing what tomorrow’s market will do.

The WEC must include all the actual costs of transacting in the wholesale energy market and the full cost of risk management. The ESC’s draft release raises grave concerns, because it shows that this has not been done appropriately. When putting together a WEC model, it must allow for the way an actual retailer hedges risk. Importantly, the model should consider:

1. The model must be open and transparent, so it can be easily verified independently
2. The seasonal nature of electricity including summer, and how this effects price & cost.
3. The kind of hedging products that are liquid and available.
4. The fact that forecast demand is an estimate, and actual demand is not known until after the fact, and the cost when actual load and the hedged load differ.
5. The cost of transactions, the cost to hold the hedging portfolio, and the funding costs to meet the wholesale market prudential requirement.
6. The important difference between Fin year and Cal year futures when setting the price for the second half of 2019.

If the above principles and cost are ignored or underestimated, then the WEC will be set too low. The draft release prompted us to compare the difference between the Frontier WEC and the actual WEC. There is a marked difference. The result is catastrophic, especially for small retailers like us who are already delivery some of the most competitive prices to consumers.

In addition, the VDO does not include the license fees being charged by the state government, while small, it is still an extra cost to retailers operating in Victoria. And finally, the ROI being set by the VDO is lower than a reasonable investor’s expectations, instead, it is even lower than the actual dividend paid by many ASX listed

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large corporate that come with far less risk. Such a low ROI does not justify the risk. Not only the market risk, but the political uncertainty and increased regulation risk that introduce costs on the industry, none of which could be forecasted.

The VDO is singly the most significant piece of regulation that has ever been introduced into the energy market. I urge you to think through very carefully the consequences of setting the VDO unrealistically low. Doing so will result in the best offers being withdrawn from the market, the destruction of competition, and a very bad outcome for consumers.

Yours sincerely,

John McCluskey / Executive Manager
GloBird Energy

Note:

*: ACCC: *"Restoring electricity affordability and Australia's competitive advantage Retail Electricity Pricing Inquiry—Final Report"*

#: *The Age*, March 8, 2019: <https://www.theage.com.au/politics/victoria/default-electricity-offer-could-slash-hundreds-from-household-bills-20190308-p512os.html>