

19 December 2012

Dr Peter Boxall AO  
Chairman  
Independent Pricing and Regulatory Tribunal  
PO Box Q290  
QVB Post Office NSW 1230

Dear Dr Boxall

### Review of Regulated Retail Prices and Charges 2013 to 2016 — Issues Paper

Thank you for the opportunity to comment on the Independent Pricing and Regulatory Tribunal's (IPART's) proposed methodology for the 2013 to 2016 Retail Price Determination.

Simply Energy is a wholly-owned subsidiary of GDF SUEZ<sup>1</sup> and one of the largest second tier retailers operating in Victoria and South Australia, and this year expanded its market presence by entering the NSW electricity market.

Simply Energy welcomes IPART's stated intention to consider what can be done to facilitate the further development of competition in NSW in this review.<sup>2</sup> This sentiment underlies much of what is in the Issues Paper and is encouraging direction for a new entrant retailer such as Simply Energy. The level at which the regulated retail price is set is one of the key uncertainties that retailers face when attempting to grow market share and expand into new markets.

We have the following comments against the Issues Paper:

- **Assessing the level of competition:** We support IPART's proposed approach to assessing the level of competition in NSW. We note that the two key factors important to facilitating further competition is allowing for plenty of headroom in the regulated price to allow for market entry and avoiding any unanticipated and significant change to the price path that IPART sets as a result of this review. We also highlight that we have experienced a degree of frustration with the NSW distributors because of their unwillingness to share information with us that has made entry more difficult for us than it should have been.
- **Retaining the weighted average price cap (WAPC):** We support retention of the WAPC approach to regulated retail prices and discourage IPART from any further consideration of an indexed-based approach. We note that index-based approaches are not appropriate for regulating retail prices and that they are a more heavy-handed and intrusive method in which the regulator effectively out-sources the regulation of prices to retailers.
- **The opt-in model:** We support IPART's proposed opt-in model and agree that opt-in will require a communication program so customers understand the change in their circumstances. We do not believe it is necessary to wait for improvements in Country Energy's situation to introduce the model

<sup>1</sup> GDF SUEZ is a leading independent electricity generating company with 75,579MW gross (43,288MW net) in operation and a significant programme of 12,820MW gross (5,868MW net) projects under construction as at 31 December 2011. Together with power generation, GDF SUEZ is also active in closely linked businesses including downstream LNG, gas distribution, desalination and retail.

<sup>2</sup> IPART 2012 Issues Paper, p. 23

into the old Integral and Energy Australia areas and that opt-in could commence in at least these two districts on 1 July 2013.

- ***Allowing headroom in the energy cost allowance:*** Simply Energy supports IPART's view that the requirement in its terms of reference to use a weighted average of the LRMC and market contract prices to determine the wholesale cost allowance should be treated as a floor price. We also set out three key factors that we suggest IPART consider in deciding whether it is in the long term interests of customers for the energy purchase cost allowance to include additional headroom in excess of this floor.

We address each of these topics in the following sections.

### ***Assessing the level of competition***

Simply Energy supports the approach that IPART is taking to assess the level of competition in the NSW market.

IPART has asked what can be done to facilitate retail market competition in NSW over the 2013 Determination period.

The two key factors in facilitating further competition are (1) allowing for plenty of headroom in the regulated price to allow for market entry (discussed further below) and (2) avoiding any unanticipated and significant change to the price path that IPART sets as a result of this review. We understand IPART is obliged under its terms of reference to review the price path on an annual basis but the more IPART can maintain the price path established under this review then the greater is the regulatory certainty that retailers have about the future environment they will be operating in. This provides confidence to invest and grow our customer base in the NSW market. Recent unanticipated actions taken by some jurisdictional regulators, in particular the Essential Services Commission of South Australia (ESCOSA), to use retail price regulation as a proxy for the competitive market and make significant changes to the level of the regulated retail price mid-way through an established price path undermines investor confidence, has the effect of reducing competition and is not in the long term interests of customers.

### ***Retaining the Weighted Average Price Cap***

Simply Energy supports IPART's intention to retain the Weighted Average Price Cap (WAPC) and would discourage IPART from any further consideration of an indexed-based approach such as the RPM methodology used by ESCOSA. Our experience with index-based approaches has proved that they are not a more light handed method of regulating prices and are instead a more heavy-handed and intrusive method in which the regulator effectively out-sources the regulation of prices to retailers.

We are aware that indexed-based approaches to regulation have been considered as a way of regulating distribution network prices. The work undertaken by the Essential Services Commission of Victoria on Total Factor Productivity is an example of some of the work that has been done.

While there may be some merit in using index-based approaches for the regulation of networks, they are not appropriate for regulating retail prices. Index-based approaches attempt to create incentives for the regulated entity to improve its productivity over time with the intention that any cost savings are returned to customers in the future. The assumption underlying the model is that the regulated entity has a large degree of control over the majority of its costs and can thus achieve real cost savings through its own management decisions. This assumption does not apply to retailers. Retailers are at the end of the energy supply chain and at least 60-70% of retailers' costs are pass throughs of the prices charged by other segments of the supply chain. A retailers' ability to achieve productivity savings under an index is much more constrained than a network

business. As a result, the index does not move enough over time for the regulated price path to continue to provide sufficient headroom to facilitate competition.

### ***The opt-in model***

Simply Energy commends IPART for developing this model and we believe it is a good model for other jurisdictional regulators to follow. In its paper, IPART queries why customers remain on the regulated tariff when there are cheaper market contracts available in the market.<sup>3</sup> While every customer will be different, much of the reason is apathy because most customers do not find their energy bill a significant burden to pay. They are often not bothered to invest the time and energy required to shop around for a better deal. The opt-in model may provoke these customers to enter the competitive market and find that better deal.

Simply Energy agrees that opt-in will require a communication program so customers understand the change in their circumstances, what it may mean for them and how to shop for a better deal. It is important that this communication program be retailer neutral and that customers are encouraged to shop beyond the incumbent retailers and try some of the second tiers.

IPART proposes that opt-in commence midway through the regulatory period to accommodate the situation in the old Country Energy area. Simply Energy does not believe it is necessary to wait for improvements in Country Energy's situation to introduce the model in the old Integral and Energy Australia areas. As noted by IPART in its 2010 review, each of the distribution areas effectively operate as separate markets and we believe the opt-in model could be introduced into the Integral and Energy Australia areas from 1 July 2013 with its introduction into the old Country Energy area at some later date.

### ***Allowing headroom in the energy cost allowance***

Simply Energy supports IPART's view that the requirement in its terms of reference to use a weighted average of the LRMC and market contract prices to determine the wholesale cost allowance should be treated as a floor price.

IPART asks how it should decide whether it is in the long term interests of customers for the energy purchase cost allowance to include additional headroom in excess of this floor.

Simply Energy suggests that IPART consider three key factors in making its decision. First, there is greater risk to consumers from setting the wholesale allowance (and thus the regulated retail price) too low than there is from setting the wholesale allowance too high. The only likely outcome from setting the wholesale cost allowance too high is that it encourages those on regulated tariffs to enter the competitive market. The higher the regulated price relative to the market price, the greater is the incentive to move to a market offer. Given IPART's stated concerns about customers not switching to more competitive offers, preserving this incentive should be a priority for IPART. In contrast, setting the wholesale cost allowance too low has the potential to severely damage competition and cause retailers to exit the market. This reduces customer choice and provides the incumbent retailers with an effective monopoly over their customer base. This is not in the long term interests of these customers.

We suggest the experience in Queensland is instructive for New South Wales. Recent decisions by the Queensland regulator on the wholesale cost of energy has resulted in a reduction in the number of second tier retailers operating in that market and, prima facie, a reduction in retail competition for consumers in that State. Between 2007-08 and 2011-12, the market share held by second tier retailers in Queensland fell from around 10% to around 5% as regulatory pricing decisions removed incentives for second tiers to participate

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<sup>3</sup> IPART 2012 Issues Paper, p. 29

in that market. Retailer churn also fell from around 20% to 13%. This impact has been outside of the decision by the Queensland Government to freeze Tariff 11 rates.

The second factor IPART should consider is that providing headroom is about providing enough ceiling space in the regulated price to allow for new entry. In other words, the regulated price should not focus on the costs that the incumbent retailer incurs but rather anticipate the costs that a new entrant retailer would incur to enter the NSW market. New entrant retailers typically sell much smaller loads than established retailers and will have a higher wholesale cost of energy than established retailers. The final energy cost allowance that makes up the regulated price must provide sufficient headroom for the higher operating costs experienced by new entrant retailers.

The third factor that IPART should consider is that no customers will be on the regulated tariffs if IPART adopts its opt-in model from 1 July 2013. Setting the energy cost allowance too high will not immediately impact any customers and will discourage customers from opting back in to the new suite of regulated tariffs. This can only assist in preparing NSW for the removal of retail price regulation at a time the NSW Government considers appropriate.

In sum, providing additional headroom in the energy cost allowance will promote competition and create stronger incentives for customers to enter the competitive market and take up the opportunity of a cheaper deal. In combination with the opt-in model, it will also make NSW customers less dependent on retail price regulation, facilitating the removal of regulation at a future time.

### ***Conclusion***

Should you have any enquiries regarding this submission, please do not hesitate to contact me on (03) 8807 1132.

Yours sincerely

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