GloBird Energy Pty Ltd
ABN 68 600 285 827
85 Maroondah Hwy, Ringwood, VIC 3134
PO BOX 398, Ringwood, VIC, 3134
globirdenergy.com.au
133 456

23 January 2023

Essential Services Commission
Level 8, 570 Bourke St
Melbourne VIC 3000

Submitted via: **www.engage.vic.gov.au**

Dear Commissioners,

RE: Victorian Default Offer 2023-24 – Consultation Paper

GloBird Energy (**GloBird**) welcomes the opportunity to provide feedback on the Essential Services Commission's (**ESC**) Victorian Default Offer 2023-24 consultation paper (**paper**).

GloBird Energy commenced operation in 2015 and has since become one of the fastest growing electricity and gas retailers in Australia, with a customer base over 145,000 residential and small business customers across Victoria, New South Wales, Queensland and South Australia. Our excellent value energy offerings, innovative products and a high-quality customer service are key drivers of our success in this highly competitive energy market.

Wholesale costs

ASX futures contracts no longer provide a reasonable proxy for a prudent retailer hedging portfolio

In the paper, the following statements were made:

"*The pricing order requires us to have regard to the efficient costs of wholesale electricity purchases.*"[1]

"*Commonly traded hedging products are future contracts on ASX Energy.*"[2]

"*We also note that while retailers use a variety of methods to hedge, including using internal physical hedges (vertical integration), power purchasing agreements and over-the-counter forward contracts, most retailers also use ASX Energy futures contracts.*

For these reasons we consider using ASX futures contracts provides a reasonable proxy for the hedging positions retailers take."[3]

The findings of the ACCC's Inquiry into the National Electricity Market November 2022 report (**report**) Highlights what GloBird and many other small retailers are experiencing:

- Commonly traded hedging products are no longer on ASX Energy .
- The assumption that most retailers use ASX Energy future contracts no longer holds.
- Small retailers have lost access to exchange-traded contracts and they must rely on over the counter (OTC) hedging contracts to manage risks; and
- OTC market is notably higher than the ASX from quarter 2 2022 onwards, putting retailers without ASX access at a disadvantage.

[1] Source: paper, s. "Wholesale costs", 2nd paragraph, p. 7.
[2] Source: paper, s. "Managing wholesale electricity risks", 3rd paragraph, p. 7.
[3] Source: paper, 4th paragraph, last sentence, and 5th paragraph first sentence, p. 9.

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"The expectation in financial markets that relatively high and volatile spot prices will persist has led to steep increases in contract prices. High contract prices have increased the credit support or 'margins' required from market participants, impacting retailers, generators and the brokers and clearing participants that facilitate trades. Some clearing participants have responded by reducing their exposure to electricity contracts on the Australian Securities Exchange (ASX); for instance, by closing out existing positions or not taking on new clients.

The result is that a number of smaller retailers have lost access to exchange-traded contracts in 2022. This means that they must rely on over-the-counter hedging contracts to manage their risk and are more likely to be exposed to high and volatile wholesale electricity spot prices, threatening their financial viability. Further, our analysis reveals that prices in the over-the-counter market were notably higher than on the ASX from quarter 2 2022 onwards, putting retailers without ASX access at a disadvantage."[4]

We appreciate that ASX Energy contracts prices are made public and therefore more transparent than its alternative. Nevertheless, the current highly volatile electricity wholesale market and the recent increase in ROLR highlight the importance of ensuring that VDO 2023-24 prices reflect retailer's risk management costs in prevailing market conditions.

"The AER should consider these findings in its review of the Default Market Offer wholesale cost methodology, and the Essential Services Commission should do so in any future reviews of the Victorian Default Offer, to ensure that regulated retail prices reflect retailers' hedging costs in prevailing market conditions."[5]

Similar message is also repeated in "Recommendation 2" of the ACCC's report.

We submit that it is justifiable to add a premium on the ASX futures contract pricing in order to estimate wholesale costs.

End date of the 12-month traded weighted average price window

Table1 in Frontier Economics (Frontier) report shows the 12-month traded weighted average ASXEnergy derivative prices for Victoria. It appears that the end date of the 12-month window is set based on an arbitrary date, perhaps when the analysis was completed. The table below lists the end date window used in past VDO decisions.

VDO	End date of the 12-month traded weighted average price window
VDO 2020	25 Oct. 19
VDO 2021	15 Oct. 20
VDO 2022	8 Oct. 21
VDO 2022-23	6 May 22 (VDO changes to financial year)

GloBird appreciates the importance of using the latest data. Nevertheless, transparency and consistency are also important.

Since the VDO decisions are now set on financial year basis, we propose that the end date of the 12-month traded weighted average price window be fixed on 30 April of the relevant year. This on one hand will provide consistency and improve transparency and on the other hand will expediate the delivery of Frontier's report.

[4] Source: ACCC's report, s. "Managing risk in increasing challenging", 3rd and 4th paragraphs, p. 2.
[5] Source ACCC's report, s. "Regulated retail prices should accurately reflect risk management costs", 3rd paragraph, p. 4

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Inconsistency of approach on whether to change/update different elements of the VDO

The Reserve Bank of Australia (RBA) utilises monetary policy to combat inflation. Therefore, the frequency and magnitude of interest rate changes are closely related to changes in inflation. When inflation reaches a level within the RBA target, interest rate increases halt.

In assessing whether to change the retail operating margin, the ESC recognises that interest rate has increased but assumed such increase is a short term change and as such has proposed not to make changes to the margin in response to short term changes.

If we follow the same logic and assume the increase in interest rate is a short term change (which we do not agree with), then this implies that the high CPI is also a short term event. Yet the ESC is proposing to respond to this short term changes by consider alternative methods to replace the CPI with the view to reduce the retail operating cost benchmark.

GloBird is supportive of competition that allows customers access to innovative offerings and reasonable prices. However, the current highly volatile wholesale costs and the recent increase in ROLR events highlight the important role of the VDO to allow retailers recovering their costs as a means of protecting competition.

We are concerned that utilising inconsistent approaches to propose changes/ updates of different elements of the VDO will create stability risk in the retail market, to the potential detriment of customers in the long term.

Retail margin

Changes in financing costs are not short term changes

The ESC is not proposing to make changes to the retail margin to account for changes in financing costs caused by increases in interest rate because these are assumed to be short term changes.

There is no evidence to suggest or support this presumption. On the contrary, there are evidence indicating that the current high interest rate environment is here to stay beyond the short-term.

In its statement dated 6 December 2022 the RBA Governor Philip Lowe highlights that global factors are contributor to the high inflation. It is well understood that the war in Ukraine and the disruption to the supply chain is causing high inflation globally. There is no evidence to suggest that the war in Ukraine is likely to be resolved soon. In fact, the indication is that it may drag for beyond the short term.

In the same statement, the RBA Governor noted that the RBA Board expects to increase interest rates further over the period ahead and forecast the inflation to decline over the next couple of years (medium term). Historically, as shown in the 20-year chart below, periods of increases in interest rates are followed by periods of no change to the high interest rate. Therefore, even if we see a pause in interest hike cycle this year, the high interest rate environment is likely to stay high for a considerable period until the RBA is confident that the gradual decrease in interest rate will contain the inflation within the desired targets.

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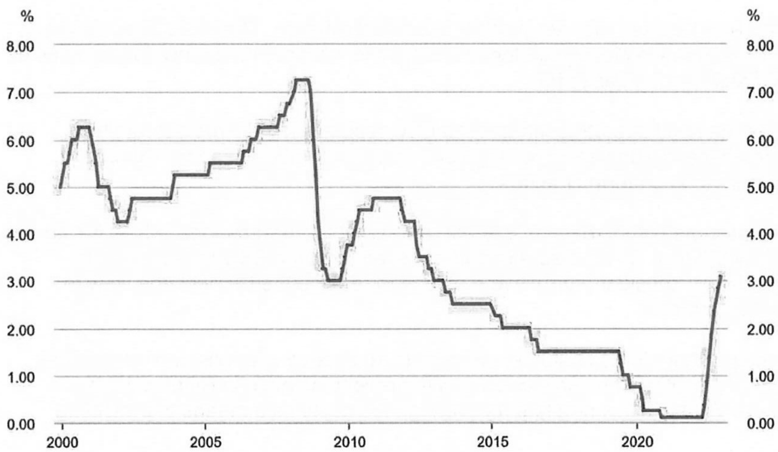
Graph of the Cash Rate Target



Source: RBA

We submit that the high interest rate environment is not a short term change and therefore the increase in financial cost should be reflected in retail margin.

Retail costs

Current approach of increasing the benchmark in line with changes in the CPI is adequate

GloBird does not support changing the current approach of increasing the benchmark in line with changes in CPI. The paper did not make a compelling case to support changing the current approach.

First, regardless of the elements contributing to the annual inflation, the CPI is used as a reference to increase wages, supplies and costs associated with maintaining billing, revenue collection and IT systems, all of which are part of retail costs.

Second, changing methodologies to achieve a desired outcome will create stability risk in the retail market. Such outcome will damper competition and will not benefit customers in the long term.

We submit that the current approach of increasing the benchmark set by the Independent Competition and Regulatory Commission for retail electricity prices in the Australian Capital in line with changes in the CPI is adequate.

Options for passing through market intervention costs

Some market intervention costs will be know when the ESC makes its decision on the VDO 2023-24 and these should be passed through at that point.

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In terms of the additional costs that will be known over subsequent months, the ESC is seeking feedback on whether these costs are to be accounted for in 2024-25 VDO or be passed through a variation to the 2023-24 VDO.

GloBird supports the passing through of these additional cost via a variation to the 2023-24 VDO if a reasonable materiality threshold is reached.

If you have any questions about this submission, please contact Nabil Chemali, Regulatory & Commercial Manager, at **nabil.chemali@globirdenergy.com.au**

Yours sincerely

John McCluskey
Executive Manager
GloBird Energy