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Australian Energy Market Commission
PO Box A2449
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Retail Competition Review – First Draft Report

Simply Energy welcomes the opportunity to comment on the Australian Energy Market Commission's (*Commission*) Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria – First Draft Report (*First Draft Report*).

Simply Energy supports the Commission's preliminary conclusion in the First Draft Report that competition in electricity and gas retailing in Victoria is effective. Some specific comments on the Commission's review are set out below.

In light of the preliminary conclusion that competition is effective, Simply Energy supports the phasing out of retail price regulation. However, it considers that phasing out price regulation over time (for example, first removing price regulation for small business customers) is unnecessary, and the phase-out should occur as soon as practicable.

5.1.3 Tariff Design

On page 62 of the First Draft Report, the Commission notes that 'While some retailers appear not to be advertising any offers at a discount to the standing offer at the current time, particularly for domestic customers, this may reflect recent changes in supply costs relative to the standing offer price.'

Simply Energy suspended active marketing of its energy products from 1 July this year, although it maintained a single fixed-rate offer which was available to residential customers during the period of suspension. The reason for suspending marketing activities was that increases in the wholesale cost of electricity meant that market offers priced at a discount to the standing offer were unprofitable.

Simply Energy recommenced active marketing in the Victorian residential sector with a discounted product on 15 October 2007. It has been able to do so because the wholesale electricity market has returned to a profitable level.

Had it not been for price regulation, Simply Energy may have continued to participate actively in the market during this period at market offer prices that reflect the underlying cost of energy. The presence of standing offer prices meant that this was not viable.

Simply Energy would be happy to provide the Commission with updated information about its current market offers.

5.3.2 Business models, target customers and differentiation of marketing strategies

The Commission notes that a number of retailers focus their telemarketing and telesales campaigns on localities that reflect their 'preferred customer' profile. In particular, the Commission states that new retailers

are likely to target their marketing efforts to areas where there is likely to be a larger proportion of customers with high energy consumption, and that retailers are less likely to contact customers with high credit risk.

While Simply Energy identifies high consumption and low credit risk as attractive customer attributes, other factors are also important. For example, a customer's propensity to churn is critical to its profitability. The cost of acquisition would typically not be recovered from a customer that churns away within the first 12 months. This leads to an incentive to target marketing campaigns at 'sticky' customers, regardless of their consumption profile.

In addition, Simply Energy's experience is that it is not possible to accurately identify high consumption customers by locality. Customers located on the same street are likely to have highly varied consumption profiles.

Further, the impacts of high levels of competition combined with the limiting effects of the Do Not Call Register mean that suburbs identified as low average credit risk are unlikely to be avoided by retailers. In reality, retailers do, and are likely to continue to, market their offers across the entire Victorian customer base.

7.2.1 Retail price regulation

The Commission notes that retailers consider the standing offer prices may act as a barrier to entry and expansion.

Price regulation acts as a barrier to entry and expansion in so much as it acts as a reference point for customer pricing that does not necessarily reflect market conditions. Regulated retail prices do not reflect the dynamic changes experienced in the electricity market.

For example, the forward curve for electricity prices increased significantly throughout 2007; however, the standing offer prices have not been adjusted since the start of 2007 to reflect this increase. This would make entry into the market by new retailers unattractive. Retailers already in the market that have been faced with reduced margins would have two options:

1. increase the prices under their market offers (to improve margins), or
2. limit the number of sales, or cease sales altogether.

The existence of the standing offer makes increased market offer prices unmarketable. Therefore, until a price correction occurs, either as an increase in the standing offer prices or a decrease in the wholesale price of electricity, there is a disincentive for existing retailers to expand their market share within Victoria.

Where prices are deregulated, it would be expected that any cost increases (such as an increase in wholesale electricity prices) or reductions would flow through more dynamically to the product offerings retailers have in the market. In such an environment, the price indicator would be the competitive prices of other retailers. The standing offer somewhat prevents this natural correction from occurring.

In addition, regulated prices also impact on upstream generation pricing. A standing offer price acts as a signal that may distort the prices that generators may otherwise offer to retailers for wholesale electricity.

7.2.2 Regulatory compliance and consistency

Simply Energy acknowledges and supports the view that the regulatory burden on Victorian energy retailers is increasing. New initiatives such as the Victorian Energy Efficiency Target scheme and the roll-out of advanced interval meters will add to a retailer's liability and administrative burden.

10.2 Advice to the Victorian Government and the MCE

If the Commission concludes that competition is effective, Simply Energy would support a recommendation that price regulation for all categories of small customers be removed. In a competitive market, prices will naturally move towards the efficient cost of supply. This will mean that customers obtain the benefits of

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efficiency gains, such as efficiencies in the cost to serve and reductions in the wholesale cost of energy, that they may not otherwise obtain with price regulation. Conversely, in the absence of price regulation, increases in wholesale energy costs would not necessarily lead to retailers being forced out of the market because market prices would reflect the underlying costs of supplying energy.

In section 10.2, the Commission notes that there may be merit in a transition period for the removal of price regulation, commencing with small business customers and moving on to residential customers later. If the Commission concludes that competition is effective and recommends that price regulation be removed, then this should occur as soon as practicable. Simply Energy does not agree that there would be any benefit in removing price regulation for one group of customers before another.

As discussed above, standing offer prices currently act as a reference point for market offer prices, such that retailers typically offer market contracts at a discount to the standing offer price. If the standing offer is removed for only one group of small customers (such as small business customers), but retained for another (residential customers), it is likely that the standing offer would continue to act as a reference point and distort the impact that complete removal of standing offers would otherwise have had. For example, a small business customer will still likely compare business market offers against the standing offers for residential customers, rather than only comparing against market offers made by competing retailers. This may limit innovation in market offers for small business customers in the short term, and not necessarily lead to the best price outcome for them.

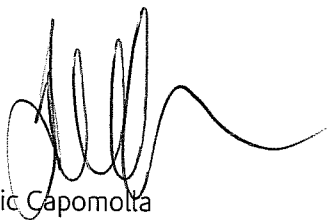
Further, Simply Energy notes that the Victorian regulatory regime for energy retail is the most far-reaching in Australia. The consumer protections provided by these regulations, including those identified by the Commission in the First Draft Report, are sufficient to protect customers who may have less than equitable access to the benefits of competition.

In any event, Simply Energy refers to the Commission's comments on page 93 of the First Draft Report that:

'there is no evidence to suggest that any particular domestic or small business customer groups are being excluded from participating in competitive energy retailing. As customer awareness of competition increases and retailer marketing activity reaches more consumers, customer participation can be expected to increase.'

For these reasons, there is no need to defer the removal of price regulation for residential customers longer than for small business customers.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Domenic Capomolla', with a stylized, flowing script.

Domenic Capomolla
CEO