amaysim Australia Limited
Level 6, 17-19 Bridge Street
Sydney, NSW 2000

T +61 2 8203 0100

info@amaysim.com.au
www.amaysim.com.au
ABN: 65 143 613 478

PUBLIC SUBMISSION

By email: electricitymonitoring@accc.gov.au

3 April 2020

Attn: Lyn Camilleri

General Manager
Electricity Markets Branch
Australian Competition & Consumer Commission (**ACCC**)
Level 17, 2 Lonsdale Street
Melbourne VIC 3000

amaysim Australia Ltd (amaysim) submission on ACCC Draft Guidelines on the Prohibiting Energy Market Misconduct Act (Act) released for consultation (Draft Guidelines)

This submission sets out amaysim's response to the Draft Guidelines issued by the ACCC, particularly in relation to the ACCC's guidance on section 153E of the Act.

Background on amaysim

amaysim entered the energy market in 2017. We are a tier two energy retailer offering innovative products in competition with the major energy retailers (including gentailers), selling electricity and gas to over 200,000 residential and small business customers nationally.

As we have said for some time, we believe that the industry needs to move away from 'acquisition offers' and 'back-book pricing' which leads consumers to assume that they are getting a good deal, only to find that the price they pay goes up over time. Our subscription energy products change this by being clear and up front about the price which the customer should expect to pay each month. They also make it obvious and clear if prices change and have an upfront, sustainable margin which is not reliant on future price rises.

Through our subscription energy products, amaysim is well placed and committed to ensure that customers have plans that are tailored to their individuals needs and that these plans are user friendly and provide genuine value.

Although we note that retailers are facing a significant and unprecedented wave of regulatory reform, we support the underlying purpose of the Act, including the premise that consumers, not just retailers, should benefit from sustained and substantial decreases in the underlying costs of procuring electricity. Our submissions on section 153E are aimed towards ensuring that the application of that section, by the ACCC, does not lead to perverse or unintended outcomes.

As a participant (and, we believe, one of the largest consumer retail participants by load) in the electricity financial contract market, we are pleased to see that further action is being taken to ensure open, transparent and liquid markets for those contracts. However, we do have some reservations

about the scope of section 153F and the ACCC's guidance on how it will investigate and prosecute that section. We have written to the Commission confidentially on those matters.

Overview

In summary, our submissions on the ACCC's Draft Guidelines in relation to section 153E are as follows:

- the final Guidelines should make it clear that the ACCC does not expect retailers to proactively reduce their current margins in order to comply with s 153E;
- the Draft Guidelines say that the ACCC does not expect retailers offering products below "cost price". However, the final Guidelines need to be clear that section 153E does not prevent a retailer from earning a fair and sustainable returning on its investment, and that "cost" in this sense, includes all retailer costs (including operating costs, capital expenditure and finance costs). In other words, a retailer's net profit after tax;
- the concept of making "reasonable adjustments" under section 153E should be considered in "dollar" terms, not "percentage" terms;
- the "reasonableness" of an adjustment should be considered on both a product and portfolio basis;
- the final Guidelines must acknowledge that a retailer's level of bad debt is relevant in assessing the "reasonableness" of an adjustment;
- the final Guidelines need to acknowledge the time and effort that it takes for retailers to make pricing changes and contemplate more flexible options than merely reducing underlying tariffs;
- previous decisions not to increase prices must be relevant to an assessment of whether it would be reasonable to expect a retailer to adjust its prices downwards; and
- the ACCC must be consistent in measuring cost reductions and adjustments by applying accounting standards consistently.

Submissions on section 153E: Prohibited Conduct – Retail Pricing

General submissions

amaysim supports the general premise of section 153E – that consumers, not just retailers, should see some of the benefits of sustained decreases in supply chain costs. We have identified several areas in the Draft Guidelines where, in our view, the ACCC should provide additional guidance or clarity to ensure the purpose of the legislation is achieved without causing unintended (and potentially perverse) outcomes for retailers and consumers.

The bulk of our submission relates to the "reasonable adjustments" concept. However, we would like to make one general comment which we believe should be made clear in the final Guidelines (which, we believe, is consistent with the observations of the ACCC in our discussions on these reforms).

The comment is that the final Guidelines should make it clear that the ACCC does not expect retailers to reduce their current margins in order to comply with section 153E – this is a forward-looking requirement (except for cost reductions in the immediate lead-up to 10 June 2020). The final Guidelines should clarify that a retailer may continue to earn the same (or even better) margin on an electricity product that it does today, provided it complies with the "reasonable adjustment" rule under section 153E.

For illustrative purposes, if a retailer is earning $20/month margin on a product today, and realised a $2 cost decrease in relation to the "underlying costs of procuring electricity" (and assuming that was deemed sustained and substantial), the retailer could conceivably pass on a $1.50 cost decrease to customers, taking the retailer's margin to $20.50, but the customer's cost down by $1.50. We are not

amaysim

commenting on the "reasonableness" of the adjustment or a retailer's margin, but merely highlight that it is arithmetically conceivable that a retailer's margin could increase at the same time as a cost reduction was substantially passed through to the customer.

"Reasonable adjustments" concept

1. **The Draft Guidelines say that the ACCC does not expect retailers offering products below "cost price". However, the final Guidelines needs to be clear that the ACCC accepts that retailers need to earn a fair and sustainable return on their investment, and that this "cost" in this sense, includes all retailer costs (including operating costs, capital expenditure and finance costs)**

The Draft Guidelines make it clear that, in the ACCC's view, section 153E does not require a retailer to adjust its prices to pass through efficiency gains leading to reduced operating costs, as only reductions relating to wholesale costs, network costs or environmental costs need to lead to price adjustments.

The Draft Guidelines also clarify that the ACCC does not expect that "compliance would require price reductions to be made when that would result in retailers needing to offer products below <u>cost price</u>" (emphasis added).

However, the Draft Guidelines tend to talk about "cost" being the "underlying cost of procuring electricity" rather than all retail costs, leaving open the implication that "cost price", in this context, refers only to those "underlying cost of procuring electricity". It is not difficult to see how this could lead to a perverse outcome where a retailer could be expected to operate at an operating loss despite earning a positive gross margin. In this section, we explain why at least three specific matters should be identified in the guidance as being relevant to the nature and extent of a "reasonable adjustment". These are:

- retail operating costs;
- capital expenditure; and
- financing costs.

While they are not "underlying costs of procuring electricity", they are all "retail costs" (insofar as they are real costs incurred by a retailer in operating its retail business) which the Explanatory Memorandum clearly identifies as a "relevant concept". [1]

The final Guidelines should also clarify that the ACCC accepts that retailers need to earn a fair and sustainable return on their investment.

Retail operating costs

As we have previously submitted to the ACCC in conference, amaysim's strong view is that retail costs (i.e. the costs of running a retail business, such as billing, marketing and customer services costs) must be included when assessing "cost price".

This is consistent with the Explanatory Memorandum, which says "the assessment of whether a corporation has contravened section 153E primarily depends on … whether, when and how adjusting prices in response to a relevant reduction would be 'reasonable', taking into account the particular circumstances of the retailer in question (<u>including that retailer's overall operating costs)</u>" (emphasis added).[2]

---

[1] Revised Explanatory Memorandum, paragraph 2.30.
[2] Ibid, paragraph 2.35.

Capital expenditure

amaysim also submits that, in determining what constitutes a "reasonable adjustment", the final Guidelines should also make it explicitly clear that a retailer's budgeted capital expenditure is relevant. We note that the Explanatory Memorandum simply talks about taking into account the "particular circumstances of the retailer in question", and while it notes "overall operating costs as a specific inclusion, the words "including" indicate that the legislators did not consider operating costs to be the sole relevant factor – merely one.[3]

Capital expenditure is a major cost of doing business, particularly for retailers:

- building innovative and customer-friendly products; and
- investing in their technology and systems in order to improve customer experience, develop competitive and innovative products, reduce billing issues and alleviating matters which generally lead to customer complaints.

Additionally, the changes to systems and processes resulting from reforms such as these may significantly increase a retailer's capital expenditure (if not its operating costs). That was the case for many retailers (including amaysim) as they rolled out the Default Market Offer and, in Victoria, the Victorian Default Offer (coupled with the Best Offer and Clear Entitlements advice reforms).

If it is left uncertain as to whether capital expenditure is relevant for the purposes of assessing what would constitute a "reasonable adjustment", then retailers are plainly disincentivised from investing capital in their product suite and technology stacks for fear that those costs will not be relevant under section 153E. That will ultimately be to the detriment of consumers.

Financing costs

amaysim also submits that, in determining what constitutes a "reasonable adjustment", the final Guidelines should also make it explicitly clear that the financing costs involved in running a retailer's business should also be considered. Every business must take into consideration its capital structure and the cost of that capital and it is appropriate for those costs to be factored into considering what is a "reasonable adjustment".

For example, many tier two retailers such as amaysim enter into "whole of meter load following hedges". These are synthetic derivatives intended to manage the relevant entity's exposure to fluctuations in the electricity spot price over an agreed period (typically 12 months). Hedge counterparties typically require retailers (such as amaysim) to post significant credit support (in the form of bank guarantees and/or cash) in support of their obligations under such load following hedges. Posting such credit support has a real cost to a business – namely, interest and issuance fees where a bank guarantee is posted by a financial institution on behalf of the retailer, and simply the time value of money, where cash is posted. There is a real opportunity "cost". The same applies in respect of retailers often being required to provide credit support to distributors.

The financing costs involved in meeting AEMO's prudential requirements by providing cash or bank guarantees to AEMO are also potentially material and certainty relevant. Similarly, the costs involved in taking out "reallocation facilities" with hedge counterparties to manage a business' prudential exposure to AEMO should also be specifically noted as relevant in assessing whether an adjustment is required, and if so, whether it is reasonable.

2. The concept of making "reasonable adjustments" under section 153E should be considered in

[3] Ibid.

"dollar" terms, not "percentage" terms

amaysim notes that each of section 153E, the Explanatory Memorandum and the Draft Guidelines leave open the question of whether retailers are expected to assess the "reasonableness" of adjustments in "dollar" or "percentage" terms.

In amaysim's view, it is critical to think about adjustments in "dollar" terms, rather than "percentage" terms. This is because:

- a retailer cannot pay its suppliers in "percentages". For example, if a retailer was selling a product at a $2 monthly margin (versus, say, an average margin of $25) and experienced a $3 reduction in its underlying costs, it would not be reasonable to expect the retailer to reduce the already small dollar margin on this product to a loss (even if the "percentage" of the total bill was low too, as would be the case here). This is particularly relevant for low revenue customers or recently acquired customers where the retailer may be making a small margin (if any); and
- customers equally cannot bank "percentages", and we know that both the government and the ACCC are keen to see "dollar" savings in consumers' pockets. That is ultimately the purpose of section 153E.

We strongly recommend that the ACCC clarifies in its final Guidelines that the "reasonableness" of an adjustment (both from the perspective of the consumer and the retailer) should be considered in dollar terms.

This recommendation aligns with our views in section 1 above as the "cost" is a dollar concept which should include all costs associated with operating a retail business (including operating costs, capital expenditure and finance costs).

3. The "reasonableness" of an adjustment should be considered on both a product and portfolio basis

The Draft Guidelines implicitly suggest that whether an adjustment to retail pricing is reasonable must be assessed on both a product and portfolio basis. However, this should be explicit in the final Guidelines.

This is because, it cannot be reasonable for downward price adjustments on either:

- individual product offerings to result in those particular products being offered "below cost" or at an unsustainable margin; or
- multiple product offerings to result in the business operating "below cost" at a loss or at an unsustainable margin level on a portfolio basis,

We would also encourage the ACCC to clarify in its final Guidelines that, as per comments made in the briefing to members of the Australian Energy Council, the ACCC does not expect that downward price adjustments must be "equal across the board" in order to be compliant. This is because if a flat dollar reduction were applied "across the board", then customers who were acquired on heavily discounted products may receive a reduction where that customer is already being serviced at a loss (or merely breaking even).

4. The final Guidelines must acknowledge that a retailer's level of bad debt is relevant in assessing the "reasonableness" of an adjustment

As the ACCC is no doubt aware, bad debt is a big issue for retailers. The impact of COVID-19 and the flow-on effects for the global and domestic economy are likely to immediately and significantly exacerbate this issue.

In our submission, a retailer's ability to pass on sustained and substantial cost reductions needs to be considered against, among other things, that retailer's level of bad debt – accounting standards require retailers to recognise bad debt at the same time as it records its revenue. To put it simply, bad debt may be the item that takes a customer from being "profit making" to "loss making" for a retailer. amaysim submits that it would be unreasonable (and inherently unfair) to require a retailer to pass through cost savings to individual customers (or customer segments) whose contribution to bad debt puts the retailer in a loss-making position (or in the position of unearning a completely unsustainable margin), on either a product or portfolio basis. We would strongly encourage the ACCC to include an example dealing with bad debt in the final Guidelines. A real would example accounting for the impacts of COVID-19 would be particularly beneficial to retailers.

5. The final Guidelines need to acknowledge the time that it takes for retailers to make pricing changes and contemplate more flexible options than merely reducing underlying tariffs

We note that the Draft Guidelines suggest that price adjustments should be made to the underlying tariffs (i.e. the base tariff rates). However, we understand the ACCC appreciates that this is a significant change for a business to implement, often requiring steps to be taken by third party billing providers (at cost to the retailer).

We strongly encourage the ACCC to have regard to the specific circumstances of each retailer in assessing the time that it takes to roll out a price adjustment. We would also welcome any flexibility the ACCC is able to suggest as to alternatives to reducing the underlying tariffs as this may ease timing of the regulatory burden on retailers and lead to consumers benefiting sooner.

6. Whether an adjustment is "reasonable" must consider previous decisions not to increase prices

We understand from the briefing provided to members of the Australian Energy Council that the ACCC will not expect a retailer who has elected not to increase their prices in response to a cost increase to then reduce their pricing later in response to that same cost reduction. The final Guidelines should effectively afford some credit for underlying cost increases absorbed by the retailer.

For example, if network costs increase and a retailer chooses not to increase customer prices in response, then that retailer will not be expected to "pass through" any "cost reduction" if those same networks costs come back down in the future. It is critical that this matter is clarified in the final Guidelines as the alternative view would lead to perverse outcomes and be unduly onerous on retailers who are already facing significant margin pressure in the wake of unprecedented regulatory reform.

7. The ACCC must be consistent in measuring cost reductions and adjustments by applying accounting standards uniformly

amaysim is concerned to ensure that all retailers are on an equal playing field when it comes to how the ACCC measures cost reductions and adjustments. Our primary concern here is that if different accounting standards are applied, then retailers will be held to different levels of accountability. In our submission, the ACCC should measure both cost reductions and adjustments using Australian International Financial Reporting Standards, on a "General Purpose" basis. We also submit that the ACCC should seriously consider appointing an external audit firm to verify its financial analysis to ensure such consistency.

We ask the ACCC to provide guidance on these matters in its final Guidelines. This will also help retailers understand the financial lens through which the ACCC will investigate and prosecute section 153E prohibited conduct.

amaysim

Conclusion

We would welcome the opportunity to discuss our recommendations with you. Please contact our Chief Strategy Officer & General Counsel, Alexander Feldman (whose email address has been provided separately) should you wish to do so.

Yours faithfully

Peter O'Connell
Chief Executive Officer
amaysim Australia Ltd