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Retail Market Review
- developing a reference price methodology
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Developing a reference price methodology for Victoria's energy market
Onsite Energy Solutions Pty Ltd (OES)

To Whom It May Concern,

OES is pleased to have an opportunity to respond to the consultation regarding the development of a reference price methodology for Victoria's energy market.

Given the Commission's obligation to deliver an initial reference price methodology to the Victorian Government within the next 10 weeks (ie. 1st July 2018), we accept that the Commission's proposed methodology is reasonable, including the use of the futures market to value wholesale electricity.

However, if the ultimate objective is to develop a methodology for determining an "efficient retail price" by the end of 2019 then we believe that improvements to the methodology should be made prior to the end of 2019, when the Commission is scheduled to deliver its "competitive review" to the Victorian Government.

An efficient retail price is only achievable if it is based upon component generation and network prices that are themselves efficient.

In Victoria there are 27 active electricity retailers, yet notwithstanding more than a decade of Full Retail Contestability, dominant market share remains heavily skewed towards Tier 1 and Tier 2 retailers (around 7 retailers hold 85% of the market). We hypothesise (as do others) that this is due to:

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1. **Wholesale market competition, not functioning properly:**

    - Lack of a level playing field in the generation market for wholesale energy, has resulted in Tier 3 retailers being unable to source cost competitive hedging arrangements. As a result the futures markets have inbuilt price inefficiencies and gentailers are conflicted in selling physical generation hedges to their "retailer only" competitors.
    - Analysis of the generation market using a long run marginal cost approach is recommended to determine the economic drivers for "ring fencing" large generation assets from gentailers, in order to create a more level playing field for the trading of wholesale energy (please refer OES' submission to DELWP Energy market Review Consultation for more details).

2. **Inflated network tariffs not structured to encourage innovation:**

    - Network tariffs which are based on "cost plus" or building block methodologies and not "market pricing" regulatory mechanisms have led to inflated rents being paid to network businesses. In our view *network prices should be equal to the value of the network to consumers* and not be based upon the book value of the network's assets. Regulators should have the power to "write down" (or "write up") the value of network assets as a function of regulatory determinations of the economic value of the network to consumers.
    - We believe that networks should offer "value reflective" tariff options, which are fixed ($ per month) for up to five (5) years.

Therefore, we propose that post 1st July 2018, in the period leading up to the delivery of the Commission's "competitiveness review" at the end of 2019, the Commission invest resources and consult with a view to gaining a deeper understanding of the competitiveness and market efficiency of both generation and network prices.

We believe that the key to realizing more competitive margins is to improve the competitiveness and market efficiency of the generation and network sectors from the perspective of Tier 3 retailers /new entrants. If achieved, this could then be expected to unleash a wave of new retail competition, innovation and improved supply side risk management to the long term benefit of consumers.

Yours faithfully,

Ronald (Bryn) Dellar
Chief Executive Officer
Onsite Energy Solutions Pty Ltd

17th April 2018