30 November 2022

Gavin Fox
A/General Manager, Market Performance
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Sent via email to: DMO@aer.gov.au

Re: Default Market Offer Prices 2023-24

I refer to your Default market offer - Price determination 2023-24 issues paper - 3 November 2022 (DMO 5) and provide thanks to the Australian Energy Regulator (AER) for the opportunity to provide a submission.

1st Energy is a non-integrated, second-tier electricity and gas retailer for residential and SME customers. Founded in April 2015, 1st Energy operates throughout the eastern states of Australia including New South Wales, Queensland, South Australia, Tasmania, and Victoria.

We recognise cost-of-living pressures are front and centre for many Australians and consumers are looking for price relief. The AER is faced with the task of setting a DMO 5 which strikes the right balance in meeting the policy objectives and we are concerned it will be artificially skewed to provide consumers protection from the actual costs to operate in the retail market. This is likely to result in a further reduction of available market offers and competition will be stymied.

The AER have posed a number of questions on the DMO 5 and 6 and we provide general commentary for your consideration.

Wholesale

In general, we agree with a 'market based' forecast approach and continuation with the current wholesale methodology with minor changes appropriate for the DMO 5 and 6. Any widescale changes would require more than a few months for a retailer to implement, subject to their business model, and if they broadly follow the wholesale methodology. 1st Energy is of the view this approach runs the risk of impacting the viability of some retailers, allows insufficient time for retailers to review and adjust their wholesale risk management strategies and will impact their capacity to fairly compete in the energy market.

As stated by the AER transparency, stability, and certainty should be at the forefront of the approach when considering the current wholesale methodology. We acknowledge calculating the wholesale cost is an imperfect science and in a period of sustained elevated wholesale spot prices a two-year build best meets these objectives. It is important that wholesales costs are calculated based on real world hedging strategies and are reflective of a prudent retailer. We continue to see power station closures with the AGL closure of Torrens Island Power Station likely to further exacerbate SA constraints and are interested to understand how the decreasing baseload availability will be factored into the DMO.

We acknowledge that customers, particularly those in vulnerable groups, are facing significant and increasing financial pressure. The high prices and volatility have also placed huge pressure on retailers resulting in a number of market exits. Ultimately the wholesale methodology needs to reflect the actual costs and not an artificial market if we are to avoid the outcomes of the UK market. Now is the moment for government to consider how they intervene or provide targeted protection for our most vulnerable. The DMO is not the mechanism to drive prices down artificially.

It is also appropriate to reconsider the shift to the 75th percentile estimate given the volatility of the wholesale market. As stated in our previous submission[1] it is our view that a 95th percentile hedged wholesale energy cost estimate remains appropriate and reflective of a prudent retailer. As industry foreshadowed it is apparent that the period of instability will continue and go on being intensified by international conflict.

With respect to the chosen load profile input the AER could consider using a weighted model whereby the net system and controlled load profile is used for the relative proportion of customers on an accumulation meter or on a smart meter.

Our preference is for the continuation of the use of ASX information for the wholesale methodology. A purchase on the ASX is considered a firm commitment whereas an options agreement is a potential transaction that may not materialise. Anecdotally we understand options are predominantly used by intermediaries and not retailers. We also consider the ASX daily closing offer price to be the most suitable price point to use as this is closest to what the contract is available to be purchased at. We do not share the view that power purchase agreements (PPAs) should be included as they are long-term contracts and lack reference to the short-term market period we are considering.

We do agree that transparency of data enables people to make informed decisions, holds the industry accountable and improves communication and where possible the data should be published in a de-identified manner.

Retail costs and allowances

As set out in our prior submission we are opposed to the 'cost-stack' DMO methodology and remain strongly concerned about the impact to smaller retailers and the harm to competition. We are opposed to an amendment of how smart meter costs are allocated and the allowance within the cost-stack as this is not an upfront cost and we are charged a daily rate for each smart meter.

In the DMO 3 the notion of the retail allowance was discussed along with a proposed transitional pathway which was implemented for DMO 4, we argued that the transitional pathway would create an artificial price cap as the actual retailer operating costs were not represented. It is of great concern that now because of higher wholesale prices which has resulted in increased risk to retailers the 'glide path' may be further delayed and compound the price cap issue further. The DMO is not the mechanism to provide vulnerable customers financial relief. Costs such as wholesale shape premiums for load following hedge contracts have moved in percentage terms in-line with the underlying wholesale cost increase. Bad debt costs are also proportionately and likely to increase as retail bills become larger across a broader group of customers. For retailers to remain viable we are looking for certainty, are already operating on small margins and do not understand the rational to now change the %.

Ultimately, retailers are looking for enough certainty so they can sufficiently manage their risk. The predicted higher prices are justifiable and the AER will be meeting the policy objectives by appropriately passing through the actual costs. For our vulnerable customers targeted assistance measures should be implemented.

For any queries regarding this response, please contact Aneta Graham, Head of Regulatory and Compliance, aneta.graham@1stenergy.com.au 03 8397 7147.

Yours sincerely

Liam Foden
Managing Director
1st Energy Pty Ltd

[1] 1st Energy Draft Determination Default Market Offer Submission 17 March 2022