17 March 2022

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

Re: Draft Determination Default Market Offer Prices 2022-23

I refer to your draft determination for retail electricity default market offer (DMO 4) prices to apply from 01 July 2022 to 30 June 2023 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.

The draft determination for the DMO 4 proposes to adopt a cost build-up approach and a shift to the 75th percentile estimate to manage wholesale forecasting risks which the AER believes best supports the policy objectives of preventing unreasonably high prices whilst enabling retailers to effectively compete below the cap. 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.

The ACCC does not consider that the AER should determine the efficient cost of supply in each jurisdiction or distribution zone, or that the AER should set the DMO at an ‘efficient’ level. The ACCC considers that inefficiencies in the supply of electricity are better tackled by facilitating effective competition between retailers that drives prices down towards efficient costs. In the recent dynamic of advertising large headline discounts, facilitating competition between retailers will involve giving retailers room to discount well below the DMO. [1]

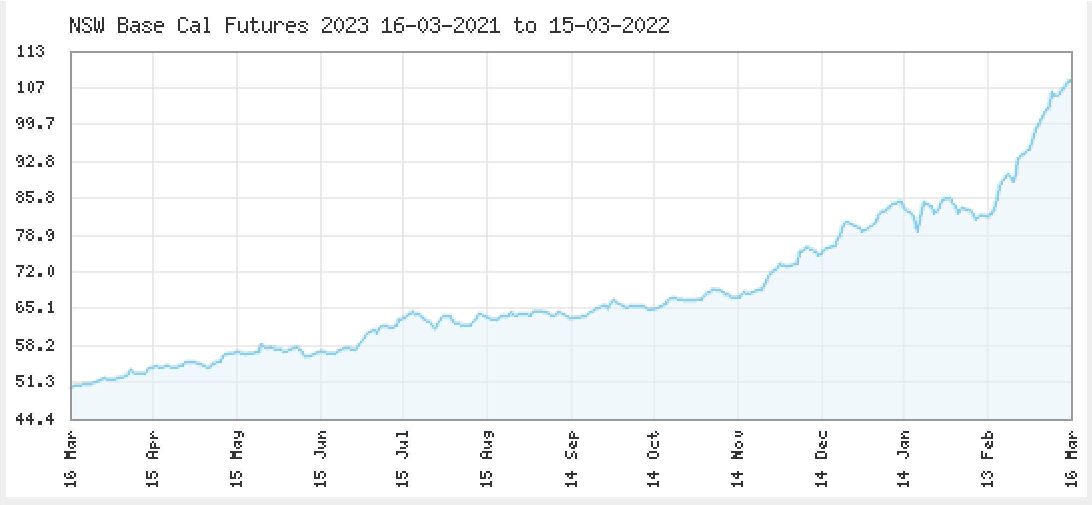
The current model has delivered on the original DMO objectives and there is no compelling or evidential based reason to change to a cost build-up approach. A cost build-up approach would seem better suited to a regulated price in the market and whilst we agree a cost build-up approach could meet policy objectives it is contingent on the accuracy of the inputs, and we are strongly concerned that the proposed inputs aren’t cost reflective nor confident we will have sufficient headroom to provide offers outside of the DMO 4. The AER have not adequately addressed retailer concerns about the influence of large retailers in the ACCC estimates, the impact to smaller retailers and the resulting harm to competition. The retail allowance percentage becomes redundant when swallowed up by understated retailer operating costs. This is further compounded by the proposed transitional pathway for the adjustment to the retail allowance component, effectively providing a price cap.

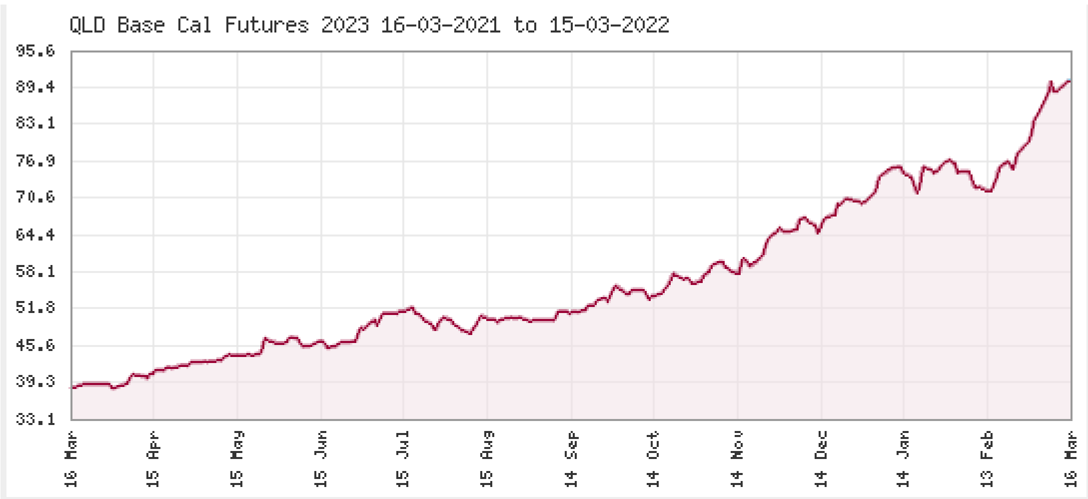
[1] https://www.aer.gov.au/system/files/ACCC%20-%20AER%20Default%20Market%20Offer%20-%20Submission%20to%20Position%20Paper%20-%207%20December%202018.PDF

Our preferred approach is the continuation of the DMO 3 methodology and whilst the ACCC data is not reflective of all retailers there could be value in using it to cross check the residual is within a tolerance, (as suggested at the AER forum on 09 March 2022).

The last nine months have documented a narrative of volatility in the wholesale market, now intensified by international conflict. Wholesale pricing has been driven by Callide C power station shutting down, extreme weather events, Liddel power station set to shut down, the rising cost of black coal and observed reduced capacity generator bidding behaviour changes from 01 July 2021.

Accordingly, we are puzzled by the shift to the 75th percentile estimate given the volatility of the wholesale market over the last nine months as evidenced by observed spot price outcomes and sharp incline in forward prices as shown in the below charts (source ASX).





It is our view that a 95th percentile hedged wholesale energy cost estimate remains appropriate and further risk should not be introduced. We do not agree that the shift to the 75th percentile estimate is acceptable for a prudent retailer in this current climate.

The narrative of upwards pressure on pricing is observed in other costs. The Queensland January 2022 $50 million reliability and emergency reserve trader (RERT) cost will have a significant per customer cost impact. Environmental costs have also accelerated over the last four months, anecdotally driven by higher corporate demand for largescale generation certificates (LGC's).

We would encourage the AER to ensure the wholesale, environmental and RERT costs flow through to the DMO 4, ask that the DMO 3 approach remains for the calculation of retailer operating costs and are supportive of the inclusion of approved network costs in the DMO 4 and future DMO final determinations. In our view it is of paramount importance that the 95% percentile estimate remains, and industry feedback is not disregarded.

It is concerning that the draft determination states that "for most customers, the DMO 4 prices under the new methodology are lower than they would have been if we had continued to use our previous methodology". We appreciate the beneficial outcome for consumers but consider this outcome is not reflective of the observed increases and we should not rely upon "judgement calls" to meet the DMO objectives.

1st Energy thanks the AER for the opportunity to provide a submission. 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
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