09 April 2024

Daniel Harding
A/g 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 2024-2025

I refer to your Default market offer prices 2024-25 Issues paper (DMO 6) 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 know people are doing it tough, the 'working poor' is now on the rise and working a full-time job and earning a decent income are no longer safeguards against experiencing extreme financial distress. As set out in our DMO submission dated 03 November 2023 the cost-of-living crisis continues to be front and centre for many Australians and we recognise consumers are looking for price relief which stakeholders have promised. Our concerns that critical elements of the DMO might be set aside to provide consumers protection from the actual costs to operate in the retail market have been realised. We believe this will result in a reduction of available market offers and competition will be stymied.

We continue to maintain the increasing cost of household bills should be appropriately supported via targeted assistance measures directed at vulnerable households, through rebate schemes and the continuation of relief packages such as the Energy Bill Relief Fund and not homogenisation of pricing in a market which is highly complex. Vulnerable customers will continue to be supported by consumer protections and if these are insufficient consideration should be given to a review and further strengthening of them.

Finally, we encourage the AER and other industry bodies to actively seek opportunities to align dates where possible to improve key data inputs and provide better DMO outcomes.

Our responses to key matters in the AER's draft decision are set out in Appendix A.

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

Appendix A

Network costs

We are supportive of the inclusion of approved network costs in the final determination and encourage the alignment of approval timings to reduce pricing risk. Where there is any misalignment, a cost true-up mechanism could apply in future years.

Wholesale costs

The AER have determined to not include small customer solar exports in the interval meter dataset that is used to create the blended profile. We are firmly of the view this is an oversight as solar PV is impacting on the times customers consume from the electricity grid, causing load to dip and spot prices to shift negative. This is resulting in spot pricing exposure to retailers because when net load and spot prices are negative we're exposed to spot price outcomes and must make payments to AEMO.

Further consideration could be given to incorporate cost allowance for retailers where spot prices are negative combined with negative net load. Our observations are a negative price combined with a negative load becomes an unhedged exposure to retailers which increases our risk profile. There is a challenge in covering off the peakiness of the load and the cost of the coverage is increasing as solar exports increase.

The AER have advised whilst we acknowledge that retailers recommended the AER revert to using the 95th percentile estimate of modelled cost outcomes, they consider that the 75th percentile strikes the right balance between retailers recovering their efficient costs of providing their services and the allocation of risks to consumers. In our view, the 95th percentile provides a default market offer prices 2024–25: draft determination significant margin of error against underestimation and is likely to result in a wholesale cost estimate that is significantly higher than what a typical retailer would incur, other than in the most extreme circumstances.

We continue with the view that a 95th percentile hedged wholesale energy cost estimate remains appropriate and reflective of a prudent retailer. Rystad Energy says a comparison of 39 electricity markets globally reveals that Australia's NEM has the widest spreads between high and low wholesale electricity prices over the course of each day, giving it "the unwanted title of 'most volatile'."[1]

Other issues

The draft determination makes no allowance for unaccounted for energy (UFE) costs to be captured in relation to global settlements. Every retailer is now billed for the loss-adjusted metered electricity that is consumed by their customers within a given region and this has a cost impost that was previously not apparent.

Environmental costs

We are supportive of using the most up to data to calculate environmental costs and would like consideration to be given for a true-up mechanism as occurs with the VDO as year-on-year environmental costs have been understated.

Retail margin and competition allowance

The AER have determined to move away from maintaining the current approach of calculating the retail allowance as a percentage of the DMO price. Instead, the retail margin will be set as a percentage of the DMO price excluding the competition allowance which will be set as a dollar figure. Additionally, for the DMO 6 the AER have determined that it is appropriate, due to economic conditions, to carve out and remove the competition allowance. We are uncertain how this allows for a stable and predictable framework for retailers to calculate margin and allowance and seek clarity on the exact mechanism for the competition allowance to be reinstated.

[1] https://www.rystadenergy.com/news/australia-electricity-market-most-volatile-in-the-wor

1st Energy Pty Ltd PO Box 16029, Collins St West VIC 8007 | www.1stenergy.com.au

The disallowance of a competition allowance sends a strong signal to the market that competition and investment by retailers is not supported. The AER themselves consider it is in the long-term interests of customers that the retail market remains competitive with many retailers offering a diverse range of market offers.

The retail market is likely to further contract as retailer margins are further eroded by unaccounted for costs such as UFE, CDR, understated environmental costs and negative solar exports. Without a true-up mechanism in place retailers must rely upon outperforming the wholesale methodology to produce reasonable gains.

Whilst we agree with the AER that increased inflation, cost of living pressures and electricity affordability are a relevant matter that the AER must have regard to, the removal of the competition allowance appears arbitrary and an opportunity to lower costs. It is our view that the competition allowance should be uncoupled from a direct linkage to CPI and that a reasonable percentage-based retail margin should be maintained that includes the costs associated with customer acquisition and retention.

1st Energy Pty Ltd PO Box 16029, Collins St West VIC 8007 | www.1stenergy.com.au