23 March 2018

Department of Environment, Land, Water and Planning
PO Box 500
Melbourne Victoria 3000

Sent via email to: EnergyMarket.Review@delwp.vic.gov.au

Re: Response to the Bipartisan Independent Review of the Electricity and Gas Retail Markets in Victoria

I refer to your consultation in respect of the Victorian Government’s interim response to the Independent Review of the Electricity and Gas Retail Market Review in Victoria, examining the operation of Victoria’s electricity and gas retail markets and provide thanks to the Victorian Government for the opportunity to provide a response.

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

1st Energy recognises the Government’s intent to implement the recommendations as set out in the Independent Review of the Electricity and Gas Retail Markets in Victoria and provides in-principle support for recommendations 3 to 11 where they promote efficient investment in, and efficient operation and use of, energy services for the long-term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy.

1st Energy is firmly of the view that recommendations 1 and 2 are unnecessary and will restrict competition and disincetivise ongoing investment in the Victorian market; ultimately undermining and destroying the very market the Government seeks to promote. In fact, the introduction of the Basic Service Offer, (BSO), may be seen to be a form of “asymmetric regulation,” and by its design impose anticompetitive restraints on non-incumbents and give advantages to incumbents.

As set out in the Thwaites Retail Energy Review final report, their research has shown however, despite lower expected costs, the Tier 1 retailers are charging customers towards the top of the price range; further entrenching their market power. Further to this the retail charge component quoted in the Thwaites review, (we note the limited analysis undertaken), are highly inconsistent with our observed retail charge component. I refer you to Appendix A which sets out our retail charge component.

We strongly urge the Government to complete a cost-benefit analysis to assess the options that provide the best approach to achieve the required benefits whilst preserving the market and to verify whether the benefits outweigh the costs, and by how much. We accept a cost-benefit analysis offers a well-educated estimate of the options and perfection in terms of economic efficiency and social welfare are not guaranteed; however, to not conduct one is inconsistent with good practices of governance. Considering the far-reaching detrimental market impacts, as illustrated by industry we believe the lack of a cost-benefit analysis is irresponsible. The Department of the Prime Minister and Cabinet provides clear guidance for policymakers in the use of a cost-benefit analysis to assess regulatory proposals.

Given the Australian Government’s commitment to the use of a cost-benefit analysis to encourage better decision making we’re surprised at the reluctance shown to date by the Victorian Government to do so.

Furthermore, we ask for clarification as to the timing of this review and the reasoning for finalising outcomes ahead of the release of the ACCC’s Electricity supply and prices inquiry final report.

In response to the consultation our responses to the specific questions are set out below; we note all items set out in our Appendices are confidential and are not to be published.

1. Are there any specific considerations the Government should be aware of if standing offer contracts were to be replaced with a regulated BSO?
2. Would the services and service standards associated with a regulated BSO be the same as those existing under the standing offer terms and conditions?

The Government should first consider the results of a cost-benefit analysis in determining the viability of replacing standing offers with a BSO.

The notion of the BSO for standing offers seems redundant at best.

As the Government has recognised immediate measures have already been adopted by Victoria’s three largest electricity retailers, AGL, Energy Australia and Origin Energy, to reduce electricity costs in 2018 for more than 285,000 Victorian residential customers on standing offer contracts⁴.

As a new entrant to the market, the customers we have on standard offers are generally limited to deemed customer retail arrangements, commonly known as unknown consumers or occupier accounts. These are customers whom refuse or fail to take appropriate steps to enter into a customer retail contract as soon as practicable.

The proposed pricing profile of the BSO doesn’t reflect the pricing profile that is associated with these customers and the ongoing risk of these customers failing to pay. Refer to Appendix B which highlights the costs associated with these accounts.

Accordingly, it appears counter intuitive to adopt a BSO which is essentially the same as a standard offer but with a non-cost reflective pricing structure.

3. Would a BSO based on a ‘flat tariff’ apply to general usage only or should it incorporate controlled load and/or solar tariffs (as is the case for standing offers)? What are the benefits and challenges associated with different approaches?
4. What other principles should the ESC consider in setting the BSO maximum regulated price profile? Should these principles differ between a BSO for electricity and a BSO for gas, residential and small business customers?
5. Are there alternatives for setting the BSO maximum regulated price profile? For example, should the ESC ‘simply’ set a BSO tariff or a specific tariff structure that must be applied by retailers?

If a BSO is to apply to our existing standard offer customers then it must reflect the tariff structures the premise currently has; anything less could be considered a consumer detriment and introduces network tariff price risk.

If Government creates a flat tariff, effectively homogenising the market, then the market offers currently available must contract in response and existing customers maybe repriced and cross subsidisations occur. The spread and availability of market offers is diminished overall and this will impact vulnerable customers and their accessibility to discounted rates and/or incentivised payment plans. Shrinking the number of options available to consumers doesn’t provide them with better options—it limits them.

Retail energy markets are complex and the amount that a retailer charges a customer for its services differs between retailer’s dependent on many factors including:

- service offerings
- network costs
- metering costs
- product offerings
- price offerings
- operational costs
- renewable and efficiency scheme costs
- regulatory costs
- wholesale costs
- acquisition programmes
- retention programmes
- customer numbers

One of the fundamental flaws in the proposed BSO is the exclusion of customer acquisition and retention costs, (CARC). Incorporating CARC is an absolute requirement of any efficiently functioning market and to exclude CARC reinforces the entrenched market power of the Tier 1’s and is prohibitive to new market entrants. Furthermore, CARC has been included in previous regulated energy markets in Australia.

6. What are the likely effects of a regulated BSO, as described above, on the energy markets (electricity and gas wholesale, distribution and retail markets, and residential and small business customers)?

In response to this question we urge the Government to complete a cost-benefit analysis and to reference the ACCC’s Electricity supply and prices inquiry final report.

1st Energy is firmly of the view that introduction of a regulated BSO is tantamount to re-regulation of electricity prices and will result in Tier 2 and Tier 3 retailers exiting the market, a significant loss of employment, (both directly and indirectly), and a restriction of competition.

Furthermore, the introduction of a BSO is likely to lead to higher prices for engaged consumers, with market offers at the bottom end of the spectrum increasing; impacting vulnerable customers and those who shop around for the cheapest deal; consequently, penalising those that choose to engage in the market.

Conversely the BSO would reduce prices for all customers on the standing tariff; essentially driving customer inertia and benefiting customers for whom affordability isn’t a concern.
7. Are there any alternative design options for price regulation (to those outlined above) that would achieve the Review’s intended outcomes?

As previously indicated our view is recommendations 3 to 11 are sufficient to deliver the desired outcomes.

We have concerns emanating from the retailer’s roundtable forum with the Energy Department on 16 March 2018 that a decision has been made that recommendations 3 – 11 aren’t sufficient to address the Government’s concerns. This is in direct conflict with the interim response which states recommendation 1 and 2 are “under consideration”.

As no cost-benefit analysis has been undertaken we find this position ill-informed as Government hasn’t assessed the potential benefits nor seen the benefits of recommendations 3 – 11 in action.

The fundamental driver for the increased costs to consumers throughout 2017 is an outcome of wholesale pricing escalating due to the decreased supply of baseload generation; essentially driven by the shutdown of coal-fired powered stations, i.e. Hazelwood without a readily available and reliable replacement source; ultimately placing upward pressure on reliable Victorian baseload generation and increasing gas costs.

However, forward electricity prices are now retracting, as evidenced in Cal 18 and Cal 19 futures prices, as new supply and forecast supply is entering the market.

8. How should the potential benefits and effects of a regulated BSO be assessed following implementation?

9. How should a regulated BSO be incorporated into Victoria’s energy sector regulatory framework?

10. Are there alternatives to introducing a regulated BSO and revoking standing offers?
    a. How would these alternatives achieve the objective and principles set by the Review?
    b. How would these alternatives affect other Review recommendations?
    c. What would be the likely effect of these alternatives on Victoria’s energy sector and energy consumers?
    d. Would these alternative approaches cause any distortions or inequities between different groups of customers?

As previously indicated our view is recommendations 3 to 11 are sufficient to deliver the desired outcomes and a regulated BSO is not required.

However, 1st Energy is supportive of targeted regulation designed to protect vulnerable/hardship customers; potentially this could be achieved through a ‘social tariff’ managed through the relevant government department and removes the ambiguity that currently exists in identifying vulnerable/hardship customers.

11. Are there any specific considerations of which the Government should be aware of if the reserve power to regulate prices was strengthened? What should be the trigger for regulation and when or under what circumstances should the regulated price requirement end?

Regulating prices will reduce competition and accordingly 1st Energy is not supportive of strengthening Government reserve powers.
1st Energy is supportive of well-placed regulation that removes unnecessary risk for innocent bystanders; however, regulation should not encourage consumers to forego trust in the market.

Consumers demonstrate daily their ability to self-regulate and make choices on what they buy and sell.

Competition stimulates businesses to lower their own costs and run their businesses as efficiently as possible and an efficient and fair market is essential for catalysing private sector development and economic growth.

Price regulation is not something that can be simply “turned on” and then “turned off”. Again, as no cost-benefit analysis on price re-regulation has been performed, we cannot recommend circumstances to support triggers for regulation or re-regulation of pricing.

Regulators are tasked with providing a regulatory environment which is predictable, sustainable and transparent, in which investors, operators, and customers can make long-term decisions with confidence that short-term political goals will not affect the efficacy of utility services.

An unpredictable regulatory environment will result in reduced investment, Tier 3 retailers exiting the market, a significant loss of employment, (both directly and indirectly), a restriction of competition and ultimately increased costs to consumers.

12. What is the most appropriate approach to implementing Recommendations 4A to 4E?
13. How can these recommendations be implemented in a timely manner?

1st Energy is strongly supportive of providing upfront notification of price changes to allow consumers to effect choice and in fact provide prior written notice to all consumers on market and standing offer contracts.

Alignment of pricing changes for all consumers to the yearly network price increase determinations may minimise disruption and inconsistent messaging to consumers. Network prices are reviewed by the AER annually to take effect from 1 January for the proceeding year and including metering charges, account for 35-45% of a retail bill and have a significant impact on the overall cost of a retail bill. An inability to change prices at the time network price changes take effect could mean network price risk is included in retail prices. This would be a perverse outcome of the review in attempting to provide lower cost outcomes for consumers.

14. What are the barriers to consumers and authorised third parties’ ability to easily access smart meter data?

1st Energy is supportive of initiatives to facilitate easy access to smart meter data; our experience has shown consumers are better to manage their consumption pattern and expenditure when they monitor their consumption or are made aware of their consumption patterns.

15. What further assistance and support programs should government consider in responding to the recommendations?
16. Are there specific recommendations or initiatives that should be prioritised due to the benefits they could elicit for low-income and vulnerable consumers?
It's our view that there's opportunity to align the concessions framework nationally to minimise administrative and operational costs. Furthermore, we encourage the Government to align to the National Energy Customer Framework thereby removing regulatory complexities and increased cost impost to consumers.

17. Are there specific groups of consumers that should be considered in addition to low-income, vulnerable and concession card consumers?
18. Are there specific single buyer or group purchasing models that would provide beneficial outcomes for vulnerable customers or concession cardholders?
19. Are there any specific issues or concerns with particular group purchasing or single buyer models for vulnerable customers or concession cardholders?

1st Energy provides no comment with regards to these questions.

20. Are there any retail market regulation issues arising from the ACCC preliminary report that the Victorian Government should consider as part of its response?

ACCC Chairman Rod Sims has stated “There is much ill-informed commentary about the drivers of Australia’s electricity affordability problem. The ACCC believes you cannot address the problem unless you have a clear idea about what caused it.”

“Armed with the clear findings on the causes of the problem, the ACCC will now focus on making recommendations that will improve electricity affordability across the National Electricity Market,” Mr Sims said.5

Again, we urge the Government to wait for the release of the ACCC’s Electricity supply and prices inquiry final report to ensure no regulatory conflicts arise.

In summary, 1st Energy is supportive of an environment that promotes competition, allowing the market to respond to pricing signals and consequently apply downward price pressure on the “big three” retailers. The market should be underpinned by sensible regulations that achieve a balance between the responsibility to protect vulnerable/hardship customers, whilst at the same time not resulting in unnecessary costs on the broader community.

1st Energy thanks the Government for the opportunity to provide a response to the consultation. 1st Energy is keen to work collaboratively with the industry to ensure customers’ needs are met in an affordable manner for all and would welcome the opportunity to participate in any ensuing discussions.

For any queries regarding this response, please contact Aneta Graham, Head of Regulatory and Compliance, aneta.graham@1stenergy.com.au 03 7001 3724.

Yours sincerely

Liam Foden
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