

17 April 2018

Essential Services Commission
Retail Market Review Implementation
Level 37
2 Lonsdale Street
Melbourne VIC 3000

Sent via email to: retailenergyreview@esc.vic.gov.au

Re: Retail market review implementation – competitiveness review

I refer to your review following the Victorian Government's interim response to the recommendations made by the Independent Review into the Electricity and Gas Retail Markets on 11 March 2018 and provide thanks to the Essential Services Commission, (ESC), 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.

The Retail Energy Review Final Report states *"The review panel recommends the introduction of a requirement for retailers to provide a 'no frills' offer, which is referred to as the Basic Service Offer"*.¹ From this point forward, Basic Service Offer will be referred to as BSO in this submission. The Victorian Government Interim Response to the Bipartisan Independent Review of the Electricity and Gas Retail Markets in Victoria states *"the ESC will also be asked to develop a methodology for a 'reference BSO price' for electricity and gas offers for residential and small business customers"*.² As such, this submission assumes the reference price methodology being developed by the ESC is the "reference BSO price" referred to in the Victorian Government Interim Response.

1st Energy reiterates our view, as outlined in our response to the Bipartisan Independent Review of the Electricity and Gas Retail Markets in Victoria, that recommendations 1 and 2 of the Bipartisan Independent Review of the Electricity and Gas Retail Markets in Victoria are unnecessary and will restrict competition and disincentives ongoing investment in the Victorian market.

1st Energy does not support the requirement for the ESC to develop a reference price by 1 July 2018. We firmly believe this does not provide the commission with the time necessary to develop an accurate and representative reference BSO price methodology. Nor does it allow the commission the necessary time to consult meaningfully with consumers, consumer advocates, energy businesses, relevant experts and other regulators.

It is our view that rushing to publish a reference price that is inaccurate and not reflective of true costs is more detrimental to consumer confidence in both the industry and the government than allowing the commission the time necessary to complete a more thorough and comprehensive review.

Network costs

Page 27 of the consultation paper says network costs are not considered further, as they are relatively straightforward in terms of approach. Where the retail price structure reflects the network tariff structure this is true.

¹ Retail Energy Review Final Report, page 54

² Victorian Government Interim Response to the Bipartisan Independent Review of the Electricity and Gas Retail Markets in Victoria, page 2

However, our understanding is the current intention is for the commission to only develop a price structure per network area (and residential and small business) similar to current single rate retail offerings (that being a fixed charge with one energy rate). This introduces network cost risk. When the consumers network tariff structure does not reflect the retail price structure, there is a risk that the network cost will not be fully recovered, hence why retail energy offers generally reflect the structure of the consumers underlying network tariff. Given network costs make up 35-45% of a typical retail bill, this risk is not insignificant.

We therefore believe that the network cost component of the reference price methodology needs to have an allowance for this risk.

Environmental scheme costs

Likewise, page 27 of the consultation paper states that environmental scheme costs are not considered further, as they are relatively straightforward in terms of approach. We do not believe this is the case. On the 29 March 2018 the Clean Energy Regulator published the 2018 small-scale technology percentage (STP). The 2018 STP is 17.08%. The non-binding 2018 STP published was 8.06%, less than half the final STP. Additionally, the 2018 STP published on 29 March 2018 takes effect retrospectively from 1 January 2018.

Where the environmental scheme cost component of the commission's reference price is set based on non-binding STP, the methodology should include an allowance for the uncertainty and risk this introduces.

Wholesale costs

1st Energy in principle supports the futures market approach to assess wholesale costs. However, for this approach to be effective separate residential and small business load profiles need to be utilised for each network area.

The time period of the futures contract prices used needs to reflect a prudent retailer's hedging strategy, and assume purchases are made to cover a retailer's load over the span of the period.

Retail operating costs

There are components of a retailers operating cost that are driven by their customers behavior. Examples of such behaviors include:

- Customers who receive correspondence via physical post impose higher printing and postage costs than those who receive correspondence via electronic means. With monthly billing now prevalent in Victoria due to the roll out of smart meters, this cost is substantially higher in Victoria than it is in other states (such as NSW) that still largely on quarterly billing.
- Customers who pay their bills over the counter at Australia Post impose higher payment processing costs than customers that pay via direct debit.
- Customers who pay their bills late impose higher working capital and credit control costs than customers who pay the invoice on time.

There are many retail products currently in the market that include additional discounts for paying the bill on time, paying via direct debit, and opting for email billing. These products reward consumers for adopting less costly behavior.

The retail operating cost used to set a "Reference BSO Price" should not incorporate such cost savings. If it does so, then retailers should be permitted to apply additional charges such as late payment fees, paper bill fees, and payment processing fees. These additional fees should be set by the commission as part of the Reference BSO Price methodology.

If the retail operating cost includes these cost savings, and retailers are not permitted to apply additional charges to consumers who opt for more costly services, then the Reference BSO Price will in fact reflect a “bells and whistles”, full service offer. Consumers who engage in lower cost behavior will be subsidising those that engage in higher cost behavior.

Energy retailers invoice their customers in arrears. The retailer will pay at least the wholesale and network costs before they receive payment from the customer. Retailers incur working capital costs to manage their cashflow while they await their customer’s payment. An offer with no incentive to pay on time, either via a conditional discount or late payment fee, should assume a higher working capital cost than an offer with such incentives.

Additionally, it is implied throughout the Retail Energy Review Final Report that the Basic Service Offer is a means to protect low income and vulnerable consumers who *“potentially face worse outcomes than the average consumer. For instance, vulnerable consumers are excluded from participating in the energy market if they cannot access products that require a certain level of income and access to technology and credit, such as direct debit deals, internet-only deals and pay-on-time discounts – particularly as these discounts bear little resemblance to the costs that retailers incur from late payment”*.³

The reality is that it costs retailers more to service low income and vulnerable consumers. Energy retailers will generally have hardship and payment plan teams dedicated to servicing these customers and working capital costs are higher due to a larger number of late payments. The bad and doubtful debt risk of this segment of consumers is also considerably higher than that of other consumers. If it is likely that the Basic Service Offer will largely service low income and vulnerable consumers, then the costs assumed in setting the offer need to acknowledge those costs associated with servicing low income and vulnerable consumers.


Fixed versus variable charges

It is unclear in the commission’s consultation paper how costs will be allocated between a fixed daily charge and an energy charge. Allocating costs such as network, wholesale, and environmental costs is relatively straight forward. 1st Energy is keen to understand how retail operating costs will be allocated. A significant portion of our overall operating costs (such as staffing costs, equipment and system costs, and regulatory costs) are impacted more by changes in customer numbers and the number of invoices being issued, rather than changes in the amount of energy being consumed by our customers.

1st Energy thanks the Commission for the opportunity to provide a response to the review. 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,

Yours sincerely



Liam Foden
Managing Director
1st Energy Pty Ltd

³ Retail Energy Review Final Report, page 38