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

Default Market Offer 2024-25 – Issues Paper

Alinta Energy welcomes the opportunity to respond to the Australian Energy Regulator's Issues Paper on the Default Market Offer for 2024-25 (DMO6).

Alinta Energy is an active investor in energy markets across Australia with an owned and contracted generation portfolio of over 3,300MW and more than one million electricity and gas customers. The DMO determination has a significant impact on our customers and our ability to compete as a second-tier energy retailer.

DMO objectives

The Issues Paper identifies the policy objectives of the DMO, including to:

- reduce unjustifiably high standing offer prices and continue to protect consumers from unreasonable prices, and
- retain incentives for consumers to engage in the market.

Setting the DMO in the long-term interests of consumers requires the AER to set a price which is sufficiently low to achieve the first objective but does not negatively impact the second objective. The difficulty of regulators in the NEM achieving those objectives was a key factor in the original decision of policy makers to remove retail price regulation.

As the AER's data demonstrates, the DMO is now set so close to the median market offer that it has gone well beyond the first objective. In effect it is now "protecting" consumers from standing offer and market contract prices set slightly above the median offer. Doing so is contrary to both the second objective of retaining incentives for consumers to engage in the market, and the long-term interests of consumers.

An alternative model

An alternative model to simultaneously achieve the DMO objectives would be for the AER to set a maximum percentage differential between individual retailer's standing and market offer prices. For example, if the value were set by the AER at 20%, retailers would be required to price their standing offer price no higher than 20% above any of their market offer prices. This simple method of price oversight would:

1. Eliminate the material risk of attempting to use regulation to identify an efficient price, which inevitably will be either too high or low;
2. Place competitive pressure on retailer's standing offer prices; and
3. Allow individual retailers to managing wholesale cost and other pricing risks in a manner that best matches their circumstances, their customers and their competitive strategy.

This approach would protect consumers from unreasonable prices (a retailer setting an unreasonably high standing offer price would be priced out of the competitive market) whilst retaining incentives for consumers to engage in the market (by permitting discounts in market offers of, in the above example, up to 20%).

To be clear, the AER would still be required to set a benchmark rate to enable price comparisons across retailers, where the benchmark rate would be used as a common base to compare retailer's prices. However, this benchmark rate would no longer also perform the function of a universal standing offer. It could be calculated in a number of ways, for example as the median of all standing offer prices.

We would welcome an opportunity to discuss this model with the AER in more detail. Our subsequent comments in this submission are made on the basis that the current form of price regulation will be retained.

Wholesale energy costs

The decision by the AER to reduce the distribution of wholesale market outcomes from the 95th to 75th percentile was made in an environment of stable wholesale prices and was cautioned against by retailers at the time on the grounds that it would have a negative impact on the retail market.

Indeed, very soon after the decision was made the wholesale market entered a period of extreme volatility which precipitated a record number of retailer failures. As the AER identifies in the Issues Paper, the retail market was characterised by minimal discounting¹ and "the convergence of the DMO price and median market offer" between the DMO4 and DMO6 periods.² Adopting the 75th percentile was a significant factor in these developments.

Consequently, given the objectives of the DMO, the convergence noted by the AER, and the risks to retail market competition in an environment of volatile wholesale market prices, we recommend the AER revert to the 95th percentile of wholesale costs. We do not share the AER's view that the 75th percentile reflects the position of a prudent retailer. Uncertainty around load profiles with the increased adoption of solar, battery storage and the installation of advanced meters add to risk across different regions of the NEM, which is not reflected at the 75th percentile simulated WEC.

With respect to the determination of hedging costs in South Australia, we support the continued use of confidential over the counter contract information sourced from retailers, but do not believe a mix of Victorian and South Australian base, peak and cap contracts overlaid with Settlement Residue Auction results would serve as a proxy to estimate hedging costs. SRAs do not shield traders from inter-regional settlement risk entirely and are not a firm insurance product to protect from such risks.

¹ AER (2023), Default market offer prices 2024-25 – Issues paper, page 4.

² Ibid., page 5.

Retail allowance

The issues paper sets out numerous changes in the approach to determine the retail allowance since the DMO was first applied. We do not support further changes to the determination of the retail allowance, particularly considering the “holistic review” of the DMO methodology undertaken prior to DMO4 (2022-23).³ Constant changes to the DMO methodology undermine retailer confidence in the price setting process with the potential to negatively impact retail competition and consumer engagement. Furthermore, the case for change has not been made and the evidence to support change has not been provided.

Of particular concern is the proposal to separate the retail allowance into a percentage efficient margin and a fixed competition allowance should not be considered for DMO6. The calculation of a fixed competition allowance is likely to be highly subjective and few reliable benchmarks are available to support any estimate of this component with any confidence.

Similarly, the glide path, which was originally designed to smooth price changes over time when adopting the 10 and 15 per cent residential and small business retail allowances but subsequently paused, should recommence for DMO6.

Advanced Meter Costs

The recommendations of the AEMC's Metering Review will require the DMO to account for the accelerated deployment of advanced meters and other costs not currently considered in the approach to its determination.

The AER should consider forecasts of meter deployments by retailers to support the accelerated program and to avoid price shocks for consumers as the roll out progresses.

Timing of network determinations

While we acknowledge the AER has taken steps to streamline the timing of network tariffs for inclusion in the DMO, as we have raised on numerous occasions in the past, network tariffs should be finalised well in advance of the DMO final determination in May. The AER is responsible for and in control of making network determinations and the DMO, however network tariffs are a key input of the DMO and the DMO itself has a far more material impact on end-use consumers.

We would welcome further discussion of this response with the Commission, please contact David Calder (David.Calder@alintaenergy.com.au) in the first instance.

Yours sincerely



Graeme Hamilton
General Manager, Regulatory & Government Affairs

³ Ibid., page 21.

Wholesale energy costs

Question 1

- What approach should we take towards estimating load profiles?
- Should we retain profiles based on the NSLP and CLP, create blended profiles using the NSLP/CLP and advanced meter data, or take another approach towards estimating load profiles?
- Which is most reflective of a reasonable retailer's approach?

Alinta Energy is supportive of applying a blended profile of the NSLP and CLP combined with advanced meter data. We support improving the accuracy of the demand profile used in the calculation of the wholesale energy cost component of the DMO. A load profile more reflective of actual customer loads will reduce the size of any errors in estimating customer load shape as the penetration of advanced meters accelerates.

Question 2

- Is the lack of transparency of AEMO's advanced meter data a major issue for stakeholders?
- What information could we provide stakeholders to address issues with transparency of data?

Lack of transparency of any blended load profile can be addressed through the publication of the load profile used and/or the method applied to calculate it. This concern is subordinate to improving the accuracy of the load profile itself.

Question 3

- How should we consider the impact of solar PV exports in advanced meter data when estimating load profiles?

Solar exports should be considered as part of any blended load profile. The NSLP will become increasingly unrepresentative of consumption pattern as it does not include customers with advanced meters, let alone customers with solar exports. However, it may not be possible to incorporate solar PV exports in advanced meter data for a blended profile in the time left to determine DMO6.

Question 4

- Should the AER determine separate load profiles for residential and small business customers?
- Is this reflective of a prudent retailer's approach?

Alinta Energy does not consider that separate residential and small business customer load profiles are required. A prudent retailer will adopt a portfolio approach to hedging both residential and small business customers. As better information from advanced metering becomes available, and the assignment of customers to cost-reflective network and retail

pricing increases, this issue should be revisited in the setting of the DMO.

Question 6

- What additional data should we consider when assessing contract pricing for DMO 6, given the lack of liquidity in South Australia remains?

Continued use of confidential OTC data is the best available solution to assess hedging for the WEC in South Australia.

Question 7

- In the absence of sufficient exchange traded South Australian contract data, what other methodologies could the AER investigate to determine the wholesale cost in South Australia?
- Would consideration of a retailer holding Victorian futures contracts with SRAs be reflective of the practice of a reasonable retailer? How would we model this?

See the response to question 6 above.

Question 8

- Should we consider any other changes to the wholesale cost methodology in light of a changing wholesale market?

The impact of coal and gas caps should already be factored into the prices of futures contracts for electricity. However, we note the AER's approach.

As discussed above, the distribution of wholesale market outcomes in determining the WEC should return to the 95th percentile s to better reflect the risks facing retailers in the wholesale market.

We support the inclusion of compensation costs determined by the AEMC and AEMO associated with market suspension in 2022 as they become known.

Retail costs

Question 9

- Do you consider these current methodologies used appropriate, and if not, what alternatives should be considered?

Approach to the retail cost stack

If the current form of price regulation is to be retained, Alinta Energy supports the continued use of the cost stack approach set out on page 16 of the issues paper as part of the DMO6 determination.

Bad and doubtful debt

Alinta Energy supports the use of ACCC Electricity Inquiry data to determine bad and doubtful debts and continuing to apply this approach for DMO6. We agree this is more representative of retailer costs than publicly reported data applied in earlier DMO determinations.

Advanced meters

Question 10

- Is the method for cost recovery of advanced metering costs appropriate for DMO 6 and/or future DMO decisions?
- If not, what alternative methods should the AER investigate to recover the cost of advanced meters?

The AER must take into account the obligations on retailers from the recommendations of the Australian Energy Market Commission's Metering Review. Retailers will need to spend significantly more on metering deployments than in previous years and recovering these costs retrospectively will impact retailer cash flows and their capacity to meet their obligations. It may be appropriate for the AER to seek information from retailers on their forecast number of installations for DMO6 (2024-25) and include these forecast costs as part of the determination.

We would encourage regular and ongoing engagement between the AEMC and the AER to ensure that new obligations placed on retailers through changes to the National Electricity Rules and National Energy Retail Rules are accounted for in the determination of advanced meter costs.

In addition to the costs of an accelerated roll out, there will be additional costs that retailers may face including customer education campaigns, support for vulnerable customers and site remediation costs where customer connection points do not comply with safety and other standards.

Question 11

- Should the AER project advanced meter installations instead of using historic data in future DMO decisions?

As discussed above, the AER should apply retailer forecasts of meter installations rather than historical installation data.

Question 12

- What operational or cash flow considerations should the AER consider in determining the cost recovery of advanced metering costs?
- How do these considerations differ between large and small retailers?

Basing advanced meter installation costs on forecast, rather than historical data, will avoid the need to for the AER to consider additional costs such as working capital impacts on retailers (whether large or small) where they under-recover deployment costs if metering installation

costs are recovered retrospectively.

Question 13

- What operational and capital expenditure advanced metering costs should the AER include in the costs recovered by retailers?
- Should these costs be subject to independent audit or review?

Retail allowance

Question 14

- Are there methodological changes that would allow us to better balance the objectives in the retail allowance?

As discussed above, Alinta Energy does not support further changes to the determination of the retail allowance. ACCC data indicates that retail margins are at historically low levels and returns to retailers the lowest since the DMO was introduced. If the current form of price regulation is to be retained, the existing approach strikes the appropriate balance across the DMO objectives.

We agree with the AER that "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."⁴ Under the current model, maintaining the existing approach to the retail allowance is key to supporting this objective.

Question 15

- Should the retail allowance be a fixed dollar amount, and if so, why?

Alinta Energy strongly opposes setting the retail allowance as a fixed dollar amount. We support the retention of the current approach to the retail allowance.

Question 16

- Alternatively, should the retail allowance be cast as separate components of efficient margin (percentage based) and additional competition allowance?
- How would these be calculated?

We do not support separating the retail allowance into separate components of an efficient margin and a competition allowance (whether expressed as percentage or fixed dollar amount). This separation will impose further risks on retailers and creates further uncertainty regarding how the calculation of the competition allowance will be determined and variations to the efficient margin over time.

⁴ AER, op. cit., page 23.

Other DMO costs and considerations

Question 19

- Should network costs be based on a blend of flat rate and time of use network tariffs?
- If so, how should this blend be calculated?

The growing use and adoption of cost reflective network tariffs needs further consideration in the determination of network costs for the DMO. Alinta Energy acknowledges that this is difficult to achieve in a transparent way.

Question 20

- Does our proposed approach to determining a broadly representative time of use pattern remain appropriate?

The current approach is likely to be broadly representative for DMO6 but may require further analysis as the advanced meter roll out progresses and cost reflective network and retail tariffs become more common. In an environment of proliferating cost-reflective and more complex tariffs, the maintenance and meaningful application of a reference price will be challenged.