

3 November 2023

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

By email to: DMO@aer.gov.au

Dear Mr Fox,

Re: Default market offer prices 2024-25: Issues paper

Simply Energy welcomes the opportunity to provide feedback on the Australian Energy Regulator's (AER) issues paper for the Default Market Offer price for 2024-25 (DMO 6).

Simply Energy is a leading energy retailer across Victoria, New South Wales, South Australia, Queensland and Western Australia. Simply Energy is owned by the ENGIE Group, one of the largest independent power producers in the world and a global leader in the transition to a zero-carbon economy. As a leading retailer focused on continual growth and development, Simply Energy supports the development of effective regulation to facilitate competition and positive consumer outcomes in the market.

Responses to questions posed in the issues paper

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?

Simply Energy strongly supports a blended approach using NSLP/CLP as well as advanced meter data. As the proportion of customers with solar continues to grow, the extra costs associated with hedging them needs to be taken into account and NSLP/CLP is no longer reflective of a typical retailer's actual exposure.

The issues paper states that between 30% and 45% of each small customer cohort have an advanced meter and that the consumption profiles of these customers would be effectively excluded if the method used in previous DMOs was applied to DMO 6. Simply Energy considers that ignoring the consumption profile of such a significant number of customers would compromise the accuracy of the DMO. Also, as the number of customers with advanced meters is set to grow further, aiming towards 100%; at some point this issue will need to be addressed and addressing it sooner has the advantage of giving opportunities to learn while the impact of errors is lower than when the percentage of advanced meters is higher.

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 visibility of the detailed data underlying a blended consumption profile developed by the AER is less of an issue for Simply Energy than a DMO based on the consumption profile of less than 70% of customers. As long as the methodology is clear, it is preferable to have accuracy over transparency. If aggregated load profiles based on the data used by the AER are provided to stakeholders then this will enable them to compare these with public information about consumption profiles and their own data. For example, the final blended load profiles could be published in Excel format by half hour, by quarter, for retailers to download and check against their actual customer profiles.

Question 3: How should we consider the impact of solar PV exports in advanced meter data when estimating load profiles?

The solar export on smart meters should be taken into account in determining the blended profile to calculate hedge cost because it represents the true exposure of retailers. Simply Energy notes that a reasonable retailer would hedge their net load from the market, which would include the 'benefit' of receiving energy fed in by customers, noting that feed-in energy continues to reduce in value, with increasing periods where it has negative value. A reasonable retailer is likely to be exposed to these negative value periods.

Question 4: Should the AER determine separate load profiles for residential and small business customers? Is this reflective of a prudent retailer's approach?

Yes. Residential and small business customers have very different load profiles and this would be taken into account by a reasonable retailer when setting prices for them. To determine a single profile, a reasonable approach would be to develop separate load profiles and aggregate them based on their prevalence in the market. This would reflect the general retailer with a mix of both residential and small business customers.

Question 5: Should the AER have a singular profile for the entire NSW region instead of individual load profiles based on distribution zone? Is this reflective of a reasonable retailer's approach?

Individual load profiles for each distribution zone in NSW should be used as this reflects a reasonable retailer's approach of pricing customers differently depending on their distribution zone. This view is supported by the issues paper reference to material profile differences between Endeavour and other distributors.

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

Simply Energy supports the AER's intention to again collect OTC contract information from retailers and generators to supplement information about contracts traded on the ASX. This will provide an understanding of the contracts used to hedge retail load in South Australia, as baseload swaps and caps are not a very effective hedge in this region. The South Australian grid is comprised predominantly of renewables and to manage price and intermittency risk large risk premiums need to be included in final hedge costs.

Simply Energy supports the AER's intention to again collect OTC contract information from retailers and generators to assess whether there are any differences in the prices traded in the different contract markets.

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?

Simply Energy strongly disagrees with the suggestion that a reasonable retailer would be able to manage its risk in relation to South Australian spot prices by purchasing a mix of Victorian and South Australian base, peak and cap contracts and using Settlements Residue Auctions (SRAs) to access inter-regional settlements residues. The price separation that can occur between these regions, which is not covered by SRAs, is significant and there are examples of this occurring in the past. This strategy is far too high risk and a reasonable risk committee would disallow inter-regional hedging for this reason.

Also, the impact of Project Energy Connect on SRAs is still being worked out, and it not clear how the suggested approach would allow a reasonable retailer to manage spot price risk given the uncertainty about this impact on SRAs. Finally, Simply Energy strongly counsels against a modelling approach that looks at past results and constructs a set of trades that would have given a good outcome, as this is no guide to how a good outcome could be achieved in future.

Question 8: Should we consider any other changes to the wholesale cost methodology in light of a changing wholesale market?

As expressed in previous submissions, Simply Energy considers that taking the 75th percentile of wholesale cost estimates as the basis for a regulated price, which all customers could potentially take up, takes insufficient account of the exposure of retailers to high prices and urges the AER to revert to a higher percentile. It would be unfortunate for customers and the market if the AER waited for multiple retailer failures (and the RoLR impacts and lost choice impacts on customers) due to exposure to high prices before addressing this issue. The use of the 75th percentile effectively means that retailers will only recover their costs 3 years out of 4, which leaves retailers exposed to a regulated tariff that they cannot rely on to cover their costs.

Simply Energy supports using the volume-weighted-average price of all base, peak and cap futures contracts traded for the 2024–25 financial year. This approach means that the DMO will take account of trades entered into at different times, which is how a reasonable retailer would progressively hedge its load. However, Simply Energy considers that it is impossible for a reasonable retailer to undertake a hedging strategy in the real world that will match the DMO outcome, and as a result a reasonable retailer will be exposed to risk that its wholesale costs exceed the DMO outcome. This risk is an additional reason for increasing the percentile of wholesale cost estimates above the 75th percentile proposed.

Question 9: Do you consider these current methodologies used appropriate, and if not, what alternatives should be considered?

Simply Energy supports the use of ACCC Electricity Inquiry data as the basis for determining bad and doubtful debt costs and considers that allowance should be made for the economic outlook for 2024-25, as identified by governments, regulators and consumer groups as putting increasing economic pressure on households, which will lead to increased bad debt costs borne by retailers.

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?

Simply Energy supports the use of actual costs reported by retailers when determining the advanced metering costs component of DMO 6. Simply Energy is not aware of evidence that these costs overstate the costs that would be incurred by a reasonable retailer.

Question 11: Should the AER project advanced meter installations instead of using historic data in future DMO decisions?

Yes, the AER should factor in the trend of increasing number of advanced meters during DMO6 period. If the AER chooses instead to apply a historical approach based on installations in the past, then the time value of money should be applied to account for the delay between incurring the costs and recovering them.

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?

Simply Energy cannot comment on how considerations may differ between large and small retailers but notes that its own approach to procuring advanced meter services is based on operational expenditure alone. Services are obtained on an annual fee-for-service basis, and no capital expenditure is incurred.

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?

All operational and capital costs incurred by retailers in providing advanced metering should be included, otherwise the regulated prices fail to account for all the costs of providing the service. If an independent view of these costs is required, Simply Energy considers that a better approach than auditing retailers would be for the AER to obtain advice from an independent consultant familiar with the advanced metering industry.

Question 14: Are there methodological changes that would allow us to better balance the objectives in the retail allowance?

Simply Energy is concerned that the AER has already deviated from the glide path it determined towards a 10% retail allowance for residential customers and a 15% allowance for small business customers over a three-year period and may deviate again for DMO 6. Simply Energy agrees that the DMO's twin objectives to incentivise retailer investment, innovation and competition in the market and the ability for customers to engage in the market mean that the DMO has additional objectives when compared to other regulated prices and that this justifies an approach that differs to other regulated prices. Simply Energy urges the AER to return to the glide path it set.

Question 15: Should the retail allowance be a fixed dollar amount, and if so, why?

Simply Energy considers that the retail allowance should continue to be expressed as a percentage of the final DMO price on grounds of consistency, simplicity and provision of regulatory certainty. The current approach better takes account of the increased market risk, potential bad and doubtful debt increases and working capital costs, which are proportional to all costs incurred by a retailer, than a fixed dollar amount.

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?

See response to question 15.

Question 17: What components are missing from the retail allowance and why?

Simply Energy is not aware of any missing components.

Question 18: Should the retail allowance differ for residential and small business consumers? If so, what risk or cost factors drive this difference and how should this be calculated?

Simply Energy agrees with the AER's conclusion that a higher retail allowance for small business customers meets the DMO objectives because it reflects the different market characteristics of this customer type. Also, Simply Energy considers that the approach to determining this allowance can be improved. The current approach uses ACCC data for 'non-residential low voltage demand tariff' customers as a proxy for small business demand tariff customers, despite this data including large commercial and industrial (C&I) customers, which leads to the retail allowance being understated. As more small business customers transition from non-demand to demand tariffs, the understatement will increase. To address this, the approach needs to take account fully of the costs of serving non-demand and demand small business customers, using data that is not compromised by the inclusion of other types of customer.

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?

Network costs should be based on a blend of flat rate, time of use, and other network tariffs that have material numbers of customers on them. The AER could establish the average consumption profile of each network tariff and weight them by volume to derive a blended network cost estimate.

Question 20: Does our proposed approach to determining a broadly representative time of use pattern remain appropriate?

Simply Energy is not aware of any potential improvements to determining a broadly representative time of use pattern, given that the DMO regulations require the AER to determine a time of use pattern in each region that is broadly representative of all customers.

Concluding remarks

Simply Energy welcomes further discussion in relation to this submission. To arrange a discussion or if you have any questions please contact Matthew Giampiccolo, Senior Regulatory Adviser, at matthew.giampiccolo@simplyenergy.com.au.

Yours sincerely



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