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Adam Day
a/g Executive Director, Default Market Offer and Consumers
Australian Energy Regulator
Canberra ACT 2601

RE: Default Market Offer 2026-27 Issues Paper

About Shell Energy and Powershop in Australia

Shell Energy delivers business energy solutions and innovation across a portfolio of electricity, gas, environmental products and energy productivity for commercial and industrial customers, while our residential energy retailing business Powershop, acquired in 2022, serves households and small business customers in Australia.

As one of the largest electricity providers to commercial and industrial businesses in Australia,[1] Shell Energy offers integrated solutions and market-leading[2] customer satisfaction, built on industry expertise and personalised service. Our generation assets include 662 megawatts of gas-fired peaking power stations in Western Australia and Queensland, to provide back-up for rising levels of renewable energy, and the 120-megawatt Gangarri solar energy development in Queensland. Shell Energy also operates the 60MW Riverina Storage System 1 in NSW.

Shell Energy Australia Pty Ltd and its subsidiaries trade as Shell Energy, while Powershop Australia Pty Ltd trades as Powershop. Further information about Shell Energy and our operations can be found on our website here.

General comments

Consultation on the Default Market Offer 8 (DMO) begins ahead of the Department of Climate Change, Energy and Environment releasing an exposure draft of updated rules reflecting the outcomes of the DMO review. Consideration of sweeping reforms without clarity on the legal framework – including new objectives and a regulated standing offer product – calls for a more measured and cautious approach.

Shifting to a tariff with a maximum annual bill is a welcome step to simplifying the operation of the DMO and supporting price change processes and product development. However, retailers may apportion the retail and wholesale cost stack across their customer book and may not distinguish between standing offer and market offer customers particularly where the services provided to customers are agnostic to the contract that they are on. Retailers may not quantify the difference in cost to serve between these cohorts.

The greatest opportunity for the industry to address affordability in the short-, medium- and long-term is to focus on the material parts of the cost stack. Network costs often represent close to half of the bill. Targeting these often-overlooked structural components of the cost stack and reducing the pace at which network capital expenditure is added to the regulated asset base before it becomes embedded in network costs, will deliver the greatest impact on affordability. By contrast, the retail cost component accounts for roughly 10% of the average consumer's energy bill.

Our submission explores the following in further detail:

- Retail costs
  - Maximum annual bill calculation, preference to use most common tariff
  - Preference to retain existing components of cost to acquire and retain customers (CARC) and align the values within the definition of 'modest'
  - Preference that bad debt is allocated as a variable cost component of the DMO

[1] By load, based on Shell Energy analysis of publicly available data.
[2] Utility Market Intelligence (UMI) survey of large commercial and industrial electricity customers of major electricity retailers, including ERM Power (now known as Shell Energy) by independent research company NTF Group in 2011-2021.

- Wholesale costs
    - Wholesale energy costs should be raised to the 95th percentile or remain at the 75th percentile
- Network costs
    - Preference to continue using corresponding network to retail tariff

Powershop thanks the AER for the opportunity to provide comments on this matter. If you would like to discuss any part of this submission, please contact Brett Crossley at brett.crossley@shellenergy.com.au.

Yours sincerely

Libby Hawker

General Manager – Regulatory Affairs and Compliance

Retail costs

Maximum annual bill calculation

In order to ensure the maximum annual bill calculation is cost-reflective, the tariff used to determine the maximum annual bill figure should be based on the most common tariff type in each distribution region. Basing the decision on the most common tariff at the time of each determination provides simplicity and certainty in process, while building in flexibility for the AER to shift with the changes in the market as the energy transition progresses and continue to ensure that the DMO remains cost reflective.

At the moment, flat rate products are common across several distribution regions, however, as the Accelerated Smart Meter Rollout commences and Time of Use (TOU) network and retail tariff structures progressively become the norm, this may need to change over time.

CARC

Powershop supports maintaining the existing scope of CARC and retaining all items currently factored into this calculation. Households on standing offers are not isolated in the marketplace and have the equivalent exposure to activity by retailers to acquire and retain them as market offer customers. Innovation by retailers to develop well priced competitive products that entice customers from standing offers is a cost retailers incur to improve customer engagement and provide enhanced customer experiences.

Option 1 (applying the standing offer customer-weighted average CARC) and Option 2 (applying the ESC's approach, which is 27% below actual cost) both entrench and favour larger, tier one retailers. This is at the expense of smaller disruptive retailers that play an important role in providing new and better products for customers and encouraging standing offer customers to engage in the market.

The absence of the competition allowance further reinforces the reasons to not pursue Option 1 or 2.

The CARC is an integral part of the cost stack that reflects costs to innovate and develop market offers that can help households maximise the value of energy supply and consumer energy resources (CER). Once customers are engaged, CARC also reflects the ongoing investment required to retain them by continuing to deliver value to households. A core purpose of the DMO is to provide a reasonable ceiling for standing offers while encouraging customers to engage with the market and seek offers that reduce their energy bills. Maintaining CARC will play an important role in supporting innovation, particularly in the context of the recent curtailment of the competition allowance.

Bad debt

Powershop supports allocating bad debt to the variable portion of the DMO tariff. While fixed cost allocation is simpler and aligns with current practice, it is regressive. Bad debt, per customer, is proportional to their bill size

(after allowing for government concessions and rebates), driven predominately by usage and would more accurately reflect the risk of bad debts being written off.

Wholesale costs

Percentile Wholesale Energy Cost (WEC) estimate

Hedging costs are premiums paid by retailers to minimise downside exposure risk across their customer book. Like a household purchasing insurance for a property in a fire-prone area, premiums are commensurate with the risk. In years where the wholesale price is subject to greater fluctuation, premiums pay-out to protect retailers from market volatility (as designed), in more stable years retailers pay premiums (hedge) without any direct benefit gained (or 'over-recovery' as characterised by the AER).

Powershop supports raising the WEC to the 95th percentile. The purpose of the WEC is to model the level of cost recovery needed for a prudent retailer to procure wholesale energy and appropriately manage risk. Retailers may typically manage wholesale market risk as a portfolio of all customers, regardless of the mix of contract types.

Whether a customer is on a standing or market offer has no bearing on the shape of their load and the approach AER adopts should accommodate retailers that hedge in aggregate.

Maintaining adequate coverage for retailers to hedge appropriately and manage market risk is critical, particularly as the energy transition structurally alters the wholesale market. This is particularly important as baseload coal assets, such as Yallourn, exit the market in the coming years and the broader impact of further scheduled high-inertia assets exiting the market remain uncertain. At the same time, rapid increase in household electrification and consumer energy resource (CER) uptake are altering the intensity, shape and volume of consumer power demand.

The dynamic nature of wholesale supply and demand are raising the level of uncertainty, and therefore retailers are bearing more risk, not less.

Costs would only be recovered in around 84% of instances if the WEC was shifted to the 50th percentile. This is inadequate and counter to how a prudent retailer would manage their risk exposures. As market volatility increases, retailers must be able to hedge appropriately and, critically, recover the cost of doing so. It is important to remember that these costs are premiums retailers pay to minimise the downside exposure risk across their customer book. Hedging exists because wholesale outcomes cannot be predicted with certainty.

It is critical to acknowledge that large retailers have greater access to working capital and bigger balance sheets to manage variability of cash flow from wholesale market risk than smaller retailers. While they are therefore able in theory to hedge less conservatively and use cash reserves to manage the upside/downside risk, small retailers have smaller buffers to absorb market risk and therefore prudently and conservatively hedge their portfolios. This disciplined approach, across large and small retailers, protects consumers and retailers from catastrophic failure.

Even if a volatility allowance was introduced, it would be almost impossible for the AER to forecast market risk accurately enough to set that allowance efficiently. Attempting to optimise the level of risk retailers are 'reasonably' expected to take within the DMO period is an unrealistic task. While in stable periods it may reasonably allocate cost, it equally gives rise to the risk of material failure, which may lead to withdrawal of retailers and market offers from the market, as retailers are unable to maintain their offering during unforeseen events that cannot be adequately hedged under the AER's model. This could adversely impact households.

Shifting to the 50th percentile could indirectly drive retailers to accept increased risk by reducing their hedging and risk management practices and therefore be exposed to significant losses in volatile periods – this is not an outcome to encourage. A middle ground at the 75th percentile would be suboptimal to the 95th percentile but would be a stable solution that supported adequate hedging.

Network mismatch

Powershop supports the simple approach for the AER to use the corresponding network tariff to retailer tariff.