AUSTRALIAN ENERGY REGULATOR

The Default Market Offer – 2020-21 Draft Determination overview

AER Policy and Performance Branch

aer.gov.au

Background - DMO and AER

- The Default Market Offer (DMO) price is the maximum price that a retailer can charge a standing offer customer each year.
- The AER's role is to annually determine:
  - the DMO price
  - A reasonable annual kWh supply amount, and the 'timing and pattern' of this supply
- First DMO determination - 1 July 2019 to 30 June 2020 (DMO 1)
- Currently consulting on DMO 2 – July 2020 to June 2021 (DMO 2)
- DMO prices applies to small business and residential standing offer customers in South Australia, New South Wales and South-east Queensland.
- The DMO price for each area is also the 'reference price'

Background - Policy context

- ACCC REPI
  - DMO is only a fall-back for those who are not engaged in the market, and should not be a low-priced alternative to a market offer.
  - DMO must achieve three objectives.

- We achieved this by setting the DMO 1 price was set at the midpoint between the median standing offer and median market offer.

1. Prevent retailers charging unjustifiably high standing offer prices

– The DMO price was lower than nearly all retailers' standing offers, including local area retailer.

2. Allow retailers to recover their efficient costs of providing services, including a reasonable retail margin.

– The DMO price was well above the median market offer in each distribution zone, which we considered was a reasonable indication of retailer's efficient costs.

3. Not reduce incentives for innovation, investment, competition and market participation by customers and retailers.

– The DMO price was significantly higher than most market offers in each distribution zone

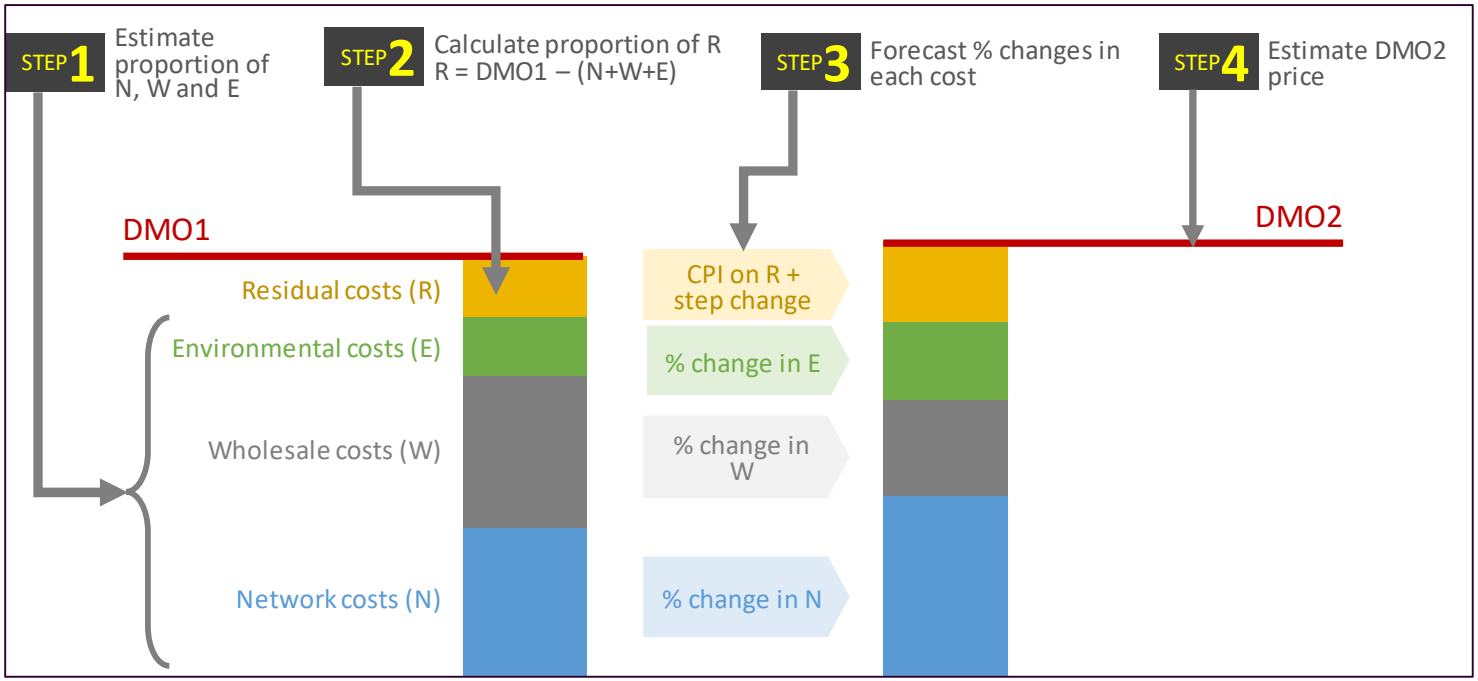
- Balancing these objectives remains a primary consideration as we go through the process of determining DMO 2 prices.

DMO 2 approach

- Replicating DMO 1 approach is unlikely to balance the policy objectives
  - With the median standing offer now around the DMO level, it would automatically result in a lower DMO price – a 'ratchet down' effect
- We considered different approaches:
  - Index the DMO based on forecast input costs changes
  - Determine new DMO using a 'bottom up' cost stack approach
  - Set the DMO in relation to observed market offer prices
- Draft Determination – an index balances the policy objectives

Our approach to setting the DMO 2 Price

Our approach to determining the price for DMO 2 is to adjust the DMO 1 price for the forecast changes in input costs.



- Wholesale electricity, environmental costs and network costs adjusted based on forecast changes
- Retail 'residual' component adjusted by CPI
- Incorporate a step change framework for exceptional retail costs, not otherwise captured
- General support for this approach

Wholesale cost forecasting

- There was general support for a market-based approach to forecasting **wholesale energy costs**. However some submissions considered that:
  - it is important to use separate load profiles for residential and SME customers
  - an allowance should be made for customer load volatility.
- Consistent with our Position Paper, our Draft Determination adopts a market based approach (using financial derivative data) to assess wholesale costs for 2020-21.
  - The forecast wholesale costs combine hedging costs (giving regard to trade-weighted contract prices) and estimated residual exposure to spot market prices, as well as other fees related to participation in the NEM wholesale market.
- In response to stakeholder submissions:
  - due to the limited data availability we propose using the same NSLP to forecast customer load profiles for residential and SME customers
  - we consider our forecasting methodology takes into account a wide range of wholesale market scenarios to capture the degree of uncertainty faced by retailers. We do not therefore provide an additional customer load volatility allowance.

Environmental cost forecasting

- For forecasting **environmental costs**:
  - A number of submissions raised concerns with using the LGC market prices to forecast LRET costs, given most of the LGCs surrendered are purchased through PPAs.
  - A number of submissions raised concerns with using the non-binding STPs to forecast SRES costs.

- Draft Determination position:
  - In response to submissions, our Consultant has calculated revised estimates for the 2020 and 2021 STPs.
  - All other aspects of our environmental cost forecasting approach remain consistent with our Position Paper.
  - Re LGCs, we agree forward market prices of LGCs will be different from the perceived LGC prices calculated using PPAs signed by participating retailers. The practical challenge for us was to use a single price that was transparent, public, and suitable to apply to all retailers.

Network costs

- In estimating **network costs**, a number of submissions supported using network annual pricing proposals rather than using price paths in regulated revenue determinations.
  - where annual pricing proposals are not available due to a regulatory reset being made, the AER should consult with network businesses to provide forecast network charges.
- Our Draft Determination position is:
  - For Endeavour, Essential and Ausgrid – indicative network tariffs from pricing proposals for 2019-20
    - For Ausgrid, not to adjust the base DMO 1 price for the impact of the remittal decision on the 2019-20 tariffs
  - for Energex and SAPN, to consider changes in annual revenue as the basis for changes in network costs in the Final Determination.

Retail residual

- The majority of stakeholders supported our approach to escalating **retail costs** by CPI and the proposed framework for retail costs step changes. However some submissions:
  - wanted more clarification on how the step changes framework would function in terms of how we define materiality and how we would deal with multiple smaller regulatory changes.
  - a few submissions stated that we should consider the costs related to 5 minute settlements as step change in retail costs for 2020-21.
- Draft Determination position:
  - Re 5MS - we assessed the information on costs provided by the retailer who responded to our request for data. The data supplied was not suitable to be solely relied upon as evidence of material costs incurred by retailers, and the costs identified by the retailer were not material.
  - Because of this, there is insufficient evidence to suggest an adjustment to the DMO price is needed.
  - We will consider any further evidence provided in response to this Draft Determination as part of finalising our Final Determination.

DMO 2 - Draft Determination

Our Draft Determination for DMO 2020-21 prices

Distribution region		Residential without CL	Residential with CL	Small Business without CL
Ausgrid	DMO 2 Price	$1,483	$2,059	$7,348
	Difference to DMO 1	+$16 (1.1%)	$0 (0%)	-$23 (-0.3%)
Endeavour	DMO 2 Price	$1,729	$2,193	$6,250
	Difference to DMO 1	+$9 (0.5%)	+$27 (1.2%)	+$46 (0.7%)
Essential	DMO 2 Price	$1,967	$2,383	$8,081
	Difference to DMO 1	+$10 (0.5%)	+$8 (0.3%)	+$36 (0.4%)
Energex	DMO 2 Price	$1,484	$1,780	$5,647
	Difference to DMO 1	-$86 (-5.5%)	-$147 (-7.6%)	-$378 (-6.3%)
SAPN	DMO 2 Price	$1,856	$2,282	$8,429
	Difference to DMO 1	-$85 (-4.4%)	-$138 (-5.7%)	-$691 (-7.6%)

In line with the legislation, the DMO prices are presented as annual bills inclusive of GST, for a specified model annual usage. Based on our consultation, the annual usage for DMO 2 remains the same as in DMO 1.

DMO - Draft Determination

What is driving the changes in DMO prices?

Residential customers without controlled load: forecast changes in cost components from 2019-20 to 2020-21

Description	Network cost	Wholesale cost	Environmental cost	Residual costs	Overall price impact
Ausgrid	+1.8%	+1.9%	-11.2%	+1.85%	**+1.1%**
Endeavour	-1.9%	+4.3%	-11.6%	+1.85%	**+0.5%**
Essential	+0.3%	+2.0%	-12.0%	+1.85%	**+0.5%**
Energex	-8.8%	-4.3%	-14.2%	+1.85%	**-5.5%**
SAPN	-5.6%	-4.3%	-12.3%	+1.85%	**-4.4%**

Small Business customers: forecast changes in cost components from 2019-20 to 2020-21

Description	Network cost	Wholesale cost	Environmental cost	Residual costs	Overall price impact
Ausgrid	-2.8%	+1.9%	-11.2%	+1.85%	**-0.3%**
Endeavour	-1.4%	+4.3%	-11.6%	+1.85%	**+0.7%**
Essential	+0.2%	+2.0%	-12.0%	+1.85%	**+0.4%**
Energex	-11.2%	-4.3%	-14.2%	+1.85%	**-6.3%**
SAPN	-13.9%	-4.3%	-12.3%	+1.85%	**-7.6%**

Time of Use

- DMO price cap now applies to residential TOU customers
- Some stakeholders do not agree it is reasonable to apply single DMO price based on flat rate to TOU customers because:
  - TOU customers cost more to supply (higher network and metering costs).
  - Our annual peak/off-peak/shoulder kWh vary from what would be typical under some network tariff structures
- There is no provision for us to determine a separate DMO price for TOU customers.
- Draft Determination - not adjust the DMO price to take into account higher prices for TOU customers:
  - While TOU **fixed** costs are marginally higher in some areas, the DMO price is sufficient to accommodate these without impacting on retailers' abilities to recover efficient costs
  - TOU **usage** costs are higher in some areas (and lower in others) due to the AER allocation/network tariff structure mis-alignment
- Our Draft Determination addresses this by introducing the daily usage profile concept. This provides retailers with flexibility to align usage to network tariff structures (or other structures)

Time of Use – daily usage profile

Essential region – 4600kWh/yr												
Time	***0000-0100***	***0100-0200***	***0200-0300***	***0300-0400***	***0400-0500***	***0500-0600***	***0600-0700***	***0700-0800***	***0800-0900***	***0900-1000***	***1000-1100***	***1100-1200***
Wk day	0.384	0.384	0.384	0.384	0.384	0.384	0.384	0.543	0.543	0.543	0.543	0.543
Wk end	0.384	0.384	0.384	0.384	0.384	0.384	0.384	0.543	0.543	0.543	0.543	0.543
Time	***1200-1300***	***1300-1400***	***1400-1500***	***1500-1600***	***1600-1700***	***1700-1800***	***1800-1900***	***1900-2000***	***2000-2100***	***2100-2200***	***2200-2300***	*2300-2400*
Wk day	0.543	0.543	0.710	0.710	0.710	0.710	0.710	0.710	0.543	0.543	0.384	0.384
Wk end	0.543	0.543	0.710	0.710	0.710	0.710	0.710	0.710	0.543	0.543	0.384	0.384

Essential Energy TOU network tariff periods	
Peak	7-9am, 5-8pm Weekdays
Off peak	10pm-7am weekdays All weekend
Shoulder	9-5, 8-10pm weekdays

Day type	Peak	Off-peak	Shoulder	Total
Weekday daily usage (kWh)	3.216	3.456	5.931	
Weekday annual usage (kWh) – 261 days	*839.376*	*902.016*	*1547.991*	
Weekend daily usage (kWh)	0	12.603	0	
Weekend daily usage (kWh) – 104 days	*0*	*1,310.712*	*0*	
Total annual usage (kWh)	**839.376**	**2,212.728**	**1,547.991**	**4,600.095**

Next steps - Key milestones for DMO 2020-21