

Default Market Offer AER Options Paper

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Overall approach

- All proposed AER DMO methodologies are workable:
 - Challenges lie in the detail
 - Important that the underlying cost is recovered
 - No correct answer – history of price regulation
- Any change from current methodology introduces significant regulatory risk
 - Potential impacts on market competition, financial viability and investment
- Policy objectives were to:
 - 1) ensure standing offer prices were not inflated, and
 - 2) provide a reference price to improve transparency/clarity for customers
- DMO has met Government's policy objectives
 - Need a good case for change

Implications of Bottom-up approach

Positives

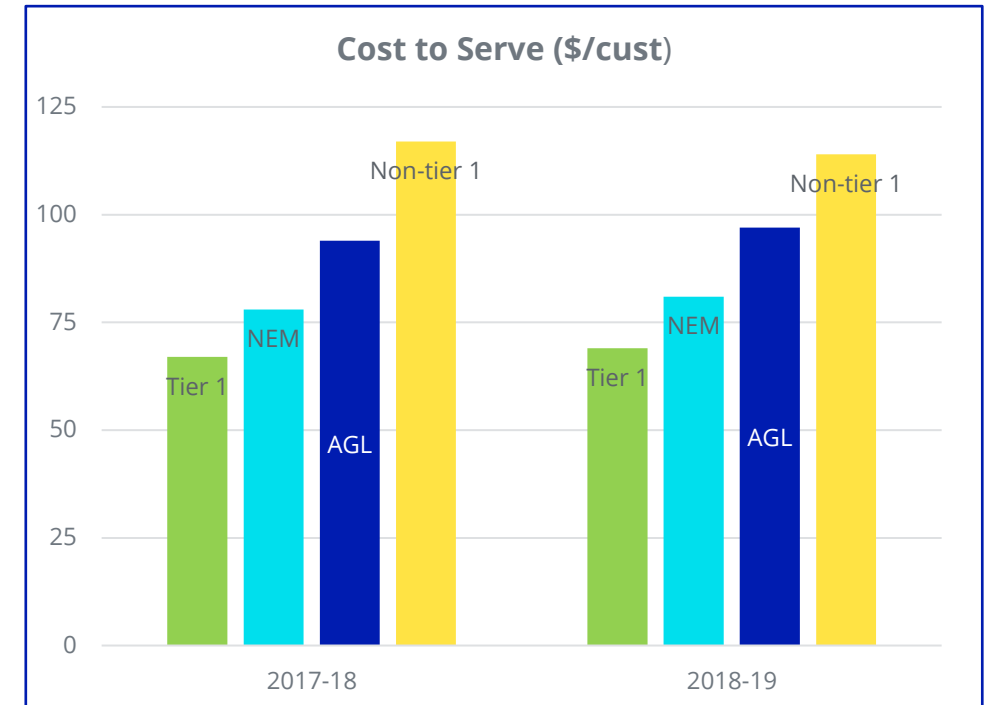
- Transparent
- Rebalances the “nominal margin” component in South Australia
- Allows AER to more easily incorporate additional cost elements
- Can be more reflective of changes in retail costs

Cons

- Need greater focus on the AER’s modelling outcomes
 - Do the level of estimates for wholesale, environmental schemes etc. reflect underlying cost?
- Required to explicitly estimate:
 - Retail Operating Cost
 - Retail Margin
 - What allowance is needed for competition and why

Retail Cost Data

- Concerns with determining the level of retail operating cost using ACCC cost data.
 - Cost to serve – retail operating costs
 - Corporate overheads/ depreciation / amortisation
 - Excludes bad debts?
- What is an average retailer (e.g. scale, type)
- How would AER select the representative retailer?



Indexation Method Issues

- Consistent residual – one-off adjustment
- Residual component could consider changes in retail cost data, rather than just CPI.
- How the AER introduces new cost elements under the indexation approach (e.g. AEMO directions)
- South Australia wholesale electricity cost
 - No liquidity
 - Infrequent trades
 - Small volumes compared with other states
 - Forward market does not reflect supply cost, impacting modelling

