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By e-mail: DMO@aer.gov.au

Default Market Offer prices 2023-24 – Issues Paper

Thank you for the opportunity to respond to the AER's issues paper on the setting of the Default Market Offer for 2023-24 (DMO5).

The determination of the DMO should be based on a stable, predictable method that provides both consumers and retailers with confidence that the price determined reflects prevailing market conditions. We therefore support the AER's view that in general, there is no case to change the method of calculating the cost components of the DMO. For those components for where change may be considered, we provide comments below.

DMO5 priority issues

Wholesale energy costs

While we support improvements to the DMO approach over time, we do not support the inclusion of confidential contract information into the WEC book build process. Contracts struck by different retailers that are not published may not reflect the approach of the prudent retailer that the DMO is intending to represent. The lack of transparency of using confidential information in an environment of high wholesale market volatility would weaken certainty and stability in the determination of the DMO for the model prudent retailer. Furthermore, it is unclear what the objective measures the AER would apply to determine if the confidential contract arrangements sourced align with the hedging strategy of a prudent retailer.

Similarly, including additional contract products at this time would add to uncertainty in the calculation of the WEC. Using the example of options, these necessarily involve less certainty (strike price, whether they are exercised, date of being exercised etc.), particularly in the current volatile environment in the wholesale market. These products are also traded and exercised by non-market participants and not always a material component of a retailer's book build. Alinta Energy recommends that the current suite of base, peak and cap contracts continue to be applied to the prudent retailer's book build. Changing elements of the assumed hedging strategy currently is unlikely to reflect the strategy retailers are committing to in real time for 2023-24.

Finally, to reflect the WEC facing a prudent retailer more accurately, as has been borne out during the market events of 2022, we recommend a return to the 95th percentile of modelled outcomes.

Retail allowance

In the issues paper, the AER state that "...our analysis of the retail allowance and glidepath and our intention to approach target retail allowance of 10 and 15% was based on our assumption of reasonably stable DMO prices across DMO 4, 5 and 6."¹

In section 7.4.3 of its final determination of May 2022, the AER did not make mention of stable DMO prices as a precondition for the retail allowance.² The purpose of glide path for over and under recovery of the retail allowance was to provide the transition on a stable basis.

Maintaining the current retail allowance would recognise the significant working capital and prudential costs faced by retailers.

Embedded network customers

We support the extension of the DMO being available to as many embedded network customers as possible. Alinta Energy also agrees with the AER that customers within embedded networks should not be charged twice for network service provision, once through the DMO and again via the embedded network operator.

The maintenance of consistent DMO customer classifications (residential, residential with controlled load and small business) across customers connected to distribution networks and those served by embedded networks is supported. This would minimise the administrative burden identified by the AER on pages 21 and 22 of the issues paper.

Other issues

Retailer failures in 2022

Open entry and exit are well-known features of a competitive market, recent exit has been involuntary rather than strategic in nature. The recent experience of systemic retailer failure in the United Kingdom and substantial costs required by government to stabilise the market since should inform decisions made in relation to price regulation in jurisdictions covered by the DMO.

Environmental costs

Alinta Energy supports the AER's view that it maintains the current approach to determining environmental costs

Network costs

While the number of customers assigned to cost reflective network tariffs (and the number of advanced meters supporting their application) is growing, Alinta Energy agrees with the AER that network costs continue to be based on flat rate tariffs. Along with other elements of the DMO, this position should be subject to review when a critical mass of non-flat network tariff structures applies to small customers.

¹ AER (2022), *Default market offer prices 2023-24 – Issues paper*, pages 19-20.

² AER (2022), *Default market offer prices 2022-23: Final determination*, pages 44-45.

A summary of Alinta Energy's responses to the questions raised by the AER are set out in the table on page 4 below.

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

Yours sincerely

A handwritten signature in blue ink, appearing to read 'G. Hamilton', is positioned above the typed name.

Graeme Hamilton

General Manager, Regulatory & Government Affairs

	Question	Response
1	Do you consider maintaining the existing methodology in the current wholesale environment is appropriate? If not, which improvements or other methodologies should we consider adopting?	Alinta Energy supports the maintenance of the existing approach to determining the WEC component of the DMO. We note the options assessed by Frontier Economics earlier this year but believe any significant change to the approach requires further analysis and the current volatile environment is not the time to depart from a stable method.
2	Does the use of net system load profiles in determining our hedging model reasonably reflect retailer risk management strategies? How could our load profile assumptions be improved?	Applying interval data from smart meters may improve the accuracy of load profiles applied in the DMO WEC modelling.
3	Do you support the inclusion of confidential contract information into the book build process? How could we make this process as robust, reliable and transparent as possible?	As discussed above, Alinta Energy does not support the inclusion of confidential contract information into the book build process.
4	Do you support the inclusion of additional contracting products in the modelling process, such as options?	As for question 3 and discussed on page 1 above, we do not support the inclusion of additional contracting products in absence of empirical evidence of the net benefit of doing so and to characterise the approach of a prudent retailer.
5	Do you support the current book build process used in the wholesale methodology component?	The period of the book build should be considered for review when other elements of the WEC and DMO cost components are assessed. Such a review should be conducted as part of a more comprehensive review of the DMO.
6	Are there any additional costs stakeholders believe should be considered in the wholesale energy cost, that have not previously been included?	Alinta Energy understands that costs of AEMO directions will be included in DMO5 as they have in previous determinations.
7	Should we consider any changes to our retail costs approach	We do not believe there is a need to change the approach to determining retail costs, but it is important to acknowledge some prudential costs and cost of working capital are effectively funded through the retail allowance.
8	Should the retail allowance be changed and, if so, in what way?	We do not believe the retail allowance (or glide path), both determined six months ago, should change at this time. Refer to page 2 of our response above.
9	What issues should the AER consider for customers in embedded networks in the DMO?	Refer to our comments on page 2 above.