

19 November 2021

Ms Stephanie Jolly General Manager, Market Performance Australian Energy Regulator GPO Box 3131 Canberra ACT 260

Submitted online via: DMO@aer.gov.au

Dear Ms. Jolly

Australian Energy Regulator (AER) Default Market Offer (DMO) Prices Options Paper for 2022-23 Determination and Subsequent years

Thank-you for the opportunity to provide a submission in response to the consultation paper titled "Default Market Offer Prices Options Paper" (Options Paper)" on the methodology to be adopted for the 2022-23 determination (and subsequent years)".

Momentum Energy Pty Ltd (Momentum) is an Australian operated energy retailer, owned by Hydro Tasmania, Australia's largest producer of renewable energy. We pride ourselves on providing competitive pricing, innovation and outstanding customer service to electricity consumers in Victoria, New South Wales, South Australia, Queensland, the ACT and on the Bass Strait Islands. We also retail natural gas to Victorian customers. We offer competitive rates to both residential and business customers along with a range of innovative energy products and services.

DMO Objectives

Based on discussions at various recent forums conducted by the AER on this topic, it is generally accepted that the DMO has delivered on its objectives by achieving a reduction in standing offer contract prices and delivering a formalised reference price for consumers to compare electricity prices. Therefore, the continued success of the DMO must be paramount when reviewing any proposed changes to the methodology used to determine future DMOs.

In summary the AER has presented three options for the DMO pricing methodology as follows:

- Option 1 Estimating retail costs and a DMO allowance (bottom up cost approach);
- Option 2 Continue indexation of the DMO residual (current model); and
- Option 3 Adjust the residual to reflect changes in retail costs using ACCC data.



The following table lists what we consider to be the risks and benefits of each DMO pricing methodology:

DMO Pricing Methodology	Benefits	Risks	Momentum Comments
Option 1 Estimating retail costs and a DMO allowance (bottom up cost approach)	 The ACCC's Electricity Monitoring Inquiry data from 2020-21 will be available in time for the DMO 4 determination that will provide a robust estimate of retail costs. Setting a consistent allowance on top of retail costs for each region and customer type to meet the DMO objectives may be a more suitable starting point for new longer term approach. Presents a more recent model (than 2018) to determine the residual which will be more aligned to current day pricing strategies. Provides more transparency on the additional cost customers are paying for not engaging in the market. A cost-based approach applied to retail costs and additional DMO allowance provides clearly defined rules for assessing each element of the DMO price. 	 Requires accurately estimated retailer costs including acquisition and retention costs. Requires an accurate determination of an allowance above typical costs to cover the retail margin and to meet the DMO objectives. Needs to accurately select the costs of an average retailer in the market. Needs to select the average type of retailer. This option also assumes that the model used to estimate wholesale energy is similar for all retailers. There is often a variance in the actual network costs due to delays in AER network determinations. Draft network costs are often used in place of actual costs. 	 The risk of getting the estimated retail, wholesale and network costs wrong for even one year could be diabolic for existing small and emerging retailers. Small and large retailers have very different cost structures and strategies to develop brand and customer acquisition and retention plans. Hence the selection of the model retailer costs represented in the DMO will not reflect all retailers in the market.
Option 2 Continue indexation of the DMO residual. (Current method).	 Has proven to deliver to DMO objectives over the past 3 years. Has allowed for incentives for retailers to compete, innovate and invest. For instance: Retailers have been competing for market share, with most offering significant discounts from the DMO reference price. 	 The size of the residual component varies across the regions and customer classes covered by the DMO. The DMO 1 price was set using market offers from October 2018 and the variance in residual reflects the market conditions at that time. These market conditions may no longer be relevant. Additionally, a 	 Proven to deliver retailer stability and ongoing competition in the market Ensures participants maintain ongoing confidence in the market. Allows reasonable residual to cover variability on costs and margins year on year.



DMO Pricing Methodology	Benefits	Risks	Momentum Comments
	 Retailers have been increasingly competing on non-price elements, including bundled services. Retailers have continued to enter the market. These outcomes provided a reasonable basis to continue the indexation approach used in previous years. That is: Estimate changes in retailers' input costs – network, wholesale and environmental costs - for the coming year; Apply forecast CPI to the DMO 3 residual component; and Consider any exogenous cost changes under the step change framework (potentially with some 	consistent margin across regions and customers may provide more consistent incentives for customers to engage in the market and pricing protections for customers that stay on standing offers and encourage further retailer entry in regions with lower margins at present.	
Option 3 Adjust the residual to reflect changes in retail costs using ACCC data.	 modification). Provides customer on standing offers with savings if retailers achieve efficiency gains greater than increases in costs to serve. Advantage of this approach over option 2 is that the ACCC data provides a basis for a transparent annual adjustment to the residual. Makes the step change framework redundant as changes in retailer costs would be reflected in the ACCC retailer cost data. 	 Has similar risks as per Option 1 as wells as it requires the costs of the average type of retailer to be selected. This approach would not address the variance in the residual between regions and customer types. 	 Risk that average costs of a large retailer is selected and not reflective of smaller retailer costs. Takes for granted that year on year estimation of costs is accurate. No allowance for variability in retailer costs. May stifle innovation and risk not developing new products by retailers. Retailers have wideranging capital costs with system upgrades and regulatory changes so costs are not flat year on year.



Preferred DMO Option

While we believe that any of the three proposed DMO pricing methodology options could deliver a reasonable outcome we do not see the need for change as the current model (Option 2) has delivered on the original DMO objectives. We also understand and are reasonably comfortable with the application of this model by the AER to adjust DMO prices over the past three years. The introduction of any new model presents additional risks of how the detail will be assessed and applied in the final pricing determination.

We see merit in adjusting Option 2 to apply a smart meter allowance as discussed in the Options Paper. The existing DMO price does not suitably compensate retailers for smart meter costs¹ which continue to cost more than the existing basic meters. Continuing to ignore this anomaly will not encourage any increase in the role out of smart meters, which has been deemed by industry experts², as an essential item required by customers to better manage their energy needs under the rapidly changing future energy market.

Momentum is also concerned that complex new regulatory obligations such as Customer Data Right, Five Minute Settlement and NEM Customer Switching impose significant additional costs³ on retailers with no material consequential benefits or operational efficiency gains. Under the Option 2 DMO pricing method these mandatory new obligations should be considered as an "exogenous cost change under the step change framework (potentially with some modification)" as noted in the Options Paper.

DMO Price Option Duration

Momentum supports a three year duration for the selected methodology to determine the DMO prices as a five year period presents undue risk to the viability of retailers. The DMO price is an important element of the competitive energy market as it sets the cap on standing offer prices and the reference price for market offers.

Should you require any further information regarding this submission, please don't hesitate to contact me on 0478 401 097 or email <u>randall.brown@momentum.com.au</u>

Yours sincerely

[Signed] Randall Brown Regulatory Manager

¹ Confidential Momentum submission to the AER DMO Prices 2021-22 Draft Determination 18 March 2021

² Energy Security Board Data Strategy Consultation Paper October 2020

³ Detailer costs were provided in the Confidential Momentum submission to the AER DMO Prices 2021-22 Draft Determination 18 March 2021