30 November 2022

Mr. Gavin Fox
A/General Manager, Market Performance
Australian Energy Regulator
GPO Box 3131
Canberra ACT 260

Submitted online via: DMO@aer.gov.au

Dear Mr. Fox

Australian Energy Regulator (AER) Default Market Offer (DMO) 2023 - 24 Issues Paper

Thank-you for the opportunity to provide a submission in response to the Default Market Offer 2023 -24 Issues Paper (Issues Paper).

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 aim to offer competitive rates to both residential and business customers along with a range of innovative energy products and services.

1. Overview

The past year has seen unprecedented challenges placed on energy market participants whereby the wholesale market has been both suspended and placed under an administered price cap. Many retailers have had to review and adapt their normal ongoing operations and six retailers have failed causing retailer of last resort events. This extraordinary period has exposed the risks of retailing in a market where prices are regulated under the default market offer (DMO). The DMO establishes a price cap for standing offer contracts and a benchmark price for all other offers to be compared to.

It is vitally important that DMO 5 suitably reflects the market situation and delivers an outcome that ensures the ongoing sustainability of market participants which is also in the long-term interests of customers.

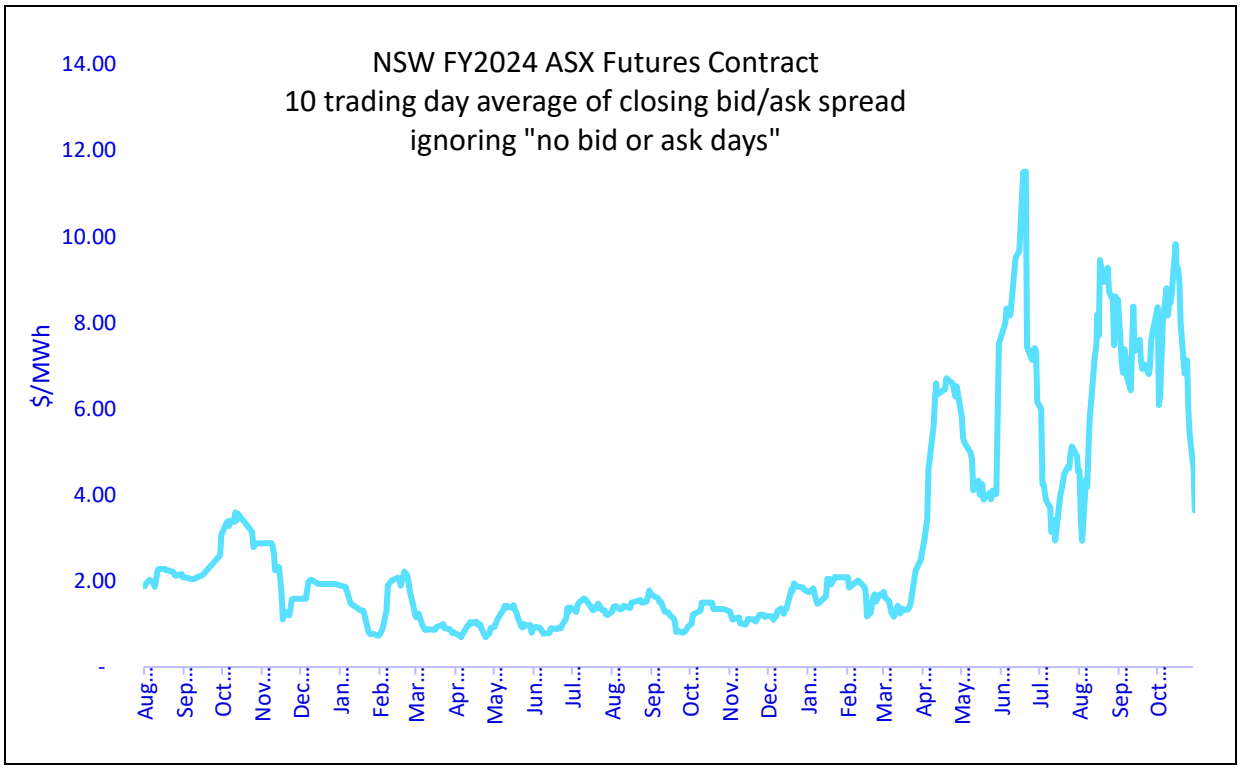
The full cost of the market suspension and period of administration is still to be determined by the Australian Energy Market Operator (AEMO) and the Australian Energy Market Commission (AEMC) with such costs to then be passed through to retailers. We would caution that the timing of these decisions and the associated cost recovery mechanisms will need to be carefully managed to minimise further stress on the market.

2. Specific Responses to the Questions Raised in the Issues Paper

Question 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?

We recognise that substantial changes to the existing wholesale price methodology (the model) are not preferred and that a consistent approach is required to ensure all stakeholders have confidence in the outputs of the model. However, the model needs to accurately reflect the wholesale cost of electricity in all market conditions including where prices are both falling and rising. The Australian Securities Exchange (ASX) electricity market, over the past year, has experienced significant price volatility. Increases in price levels, price volatility and interest rates have increased ASX initial margin funding costs that must be reflected in the model.

It is our experience, supported by ASX futures price data in the chart below, that bid/ask price spreads have widened substantially due to recent price increases and volatility in the contract hedging market. This increases actual hedging costs through higher prices paid by retailers at the time they want to enter into a hedge, compared to the deemed ASX price reflected in the model and this results in a substantial under recovery.



Question2: 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?

Momentum believes that the net system load profile (NSLP) continues to represent the load that most retailers will hedge against. In NSW, ACT, QLD and SA [1] only 25% of premises have smart meters therefore a change away from the NSLP is not appropriate at this stage. As mentioned in the issues paper any move away from the NSLP will remove transparency from the inputs to the model.

Question 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?

We do not support the inclusion of confidential contract information into the book build process. We are concerned that the inclusion of confidential contract information will be administratively burdensome and be overly intrusive into the commercial operation of a retailers' business. It would also disincentivise efficient hedging if more efficiently hedged retailers are "punished" for hedging at better prices, compared to relatively inefficiently hedged retailers with higher hedge costs.

The original purpose of the DMO, as stated by the ACCC was, "to act as a fall-back for those who are not engaged in the market and should not be a low-priced alternative to a market offer"[2], hence we believe that the inputs to the DMO can be more than adequately determined via information that is transparent and publicly available.

Question 4: Do you support the inclusion of additional contracting products in the modelling process, such as options?

We do not believe the inclusion of options contracts in the modelling process is practical. Options regularly trade multiple times more energy than futures trade however, determining their true cost as a standalone price hedge (i.e. implied volatility level) is very challenging to value due to the high proportion of option-spread trades and difficulty benchmarking implied volatility because the underlying futures fair value at the moment of trade, is difficult to estimate and audit.

Over the counter broker indicators of option implied volatility costs could be used as a gauge, but estimating the actual ASX option volume and specific trades, that could have provided an effective price hedge (rather than option spread trades which may provide only partial hedge cover), is highly assumption-dependent and potentially misleading. On this

[1] https://www.aemc.gov.au/news-centre/media-releases/aemc-sets-out-metering-options-smarter-energy-future

[2] Page 4 https://www.aer.gov.au/system/files/AER%20-%20Default%20market%20offer%20-%20Price%20determination%202023-24%20issues%20paper%20-%203%20November%202022_0.pdf

basis, we suggest that adding another layer of complexity, by including options, will likely increase the opacity of the model and should be avoided.

Question 6: Are there are any additional costs stakeholders believe should be considered in the wholesale energy cost, that have not previously been included?

The Issues Paper has indicated that only the AEMO determined costs of the suspension of the market in 2022 are likely to be known and included in the DMO 5, with the remaining AEMC determined costs still to be determined and recovered. Momentum is concerned that there is likely to be a considerable lag time between when the AEMC determined costs are billed to retailers and the subsequent inclusion of these costs in DMO 6. The additional cost of funding the delay in recovery could be substantial and we suggest that this places an unexpected financial burden on retailers that requires changes to the DMO model. The possible solutions could be a DMO end of year reopener or a suitable allowance in DMO 5 to cover an estimate of the funding costs.

Question7: should we consider any changes to our retail costs approach?

Several recent regulatory changes introduced into the energy market such as "Better Bills" and the "Customer Data Right" have not been subjected to a detailed cost benefit assessment. These regulatory changes have been imposed on the market regardless of costs with no evidence of any off-setting efficiency benefits.

It is Momentum's understanding that regulatory change costs are currently recovered as part of the EBITDA retail margin included in the retail allowance. We believe that this approach does not adequately allow for recovery of these capital and operational costs for retailers with significantly less customers than larger retailers to recover costs against, and it over states the "retail margin". This places an unfair cost burden on smaller retailers compared to larger retailers.

Momentum believes that regulatory change costs should be assessed separately under a depreciation and amortisation factor, to be included in the DMO cost stack, that could determine the median retailer change cost of each new regulatory obligation. This would provide greater transparency to consumers, regulators, and governments of the price impact that each new regulatory change imposes on consumers.

Question 8: Should the retail allowance be changed and, if so, in what way?

We support the intended glidepath to 10% residential and 15% small medium enterprise retail allowances, across all networks areas during DMO 5 and DMO 6, as proposed during DMO 4 consultations. Regardless of the wholesale price volatility experienced since DMO 4 we believe that the proposed glidepath assists competitive outcomes in all network areas which will ultimately be in the long-term interests of customers.

3. Environmental Costs

We note your reference to the various national and jurisdictional environmental schemes and your decision, in the DMO 4 final determination, to continue to retain a market-based approach to environmental cost forecasting. We draw your attention to the NSW Peak Demand Reduction Scheme which commenced in November 2022 with compliance obligations taking effect from April 2023. We would suggest that this scheme should be included in any cost forecasting going forward.

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

Yours sincerely

[Signed]
Randall Brown
Regulatory Manager