9 March 2020

Mr Mark Feather
General Manager, Policy and Performance
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Email: DMO@aer.gov.au

Dear Mr Feather,

RE: DRAFT DETERMNATION DEFAULT MARKET OFFER PRICES 2020-21

Origin Energy appreciates the opportunity to provide a submission to the Australian Energy Regulator's (AER) draft determination for *Default Market Offer Prices 2020-21*.

Origin supports the introduction of the default market offer (DMO) as a safety net price. However, as we have stated previously, introducing a regulated price carries significant risks to the efficient operation of a market as a result of regulatory error. If the DMO price is set too high, then we would expect more intense competition will compete away any excess margin over time. On the other hand, if the DMO price is too low, then this will more likely negatively impact competition.

We consider that the indexation method the AER has adopted to set the DMO 2 provides retailers with a reasonable opportunity to recover their efficient costs. However, we are concerned that the AER's approach to not allow retailers to recover costs associated with five-minute-settlements will have a material and detrimental impact.

Origin's response to specific matters is set out below.

Wholesale Energy Costs

We consider one of the most important aspects in the calculation of the DMO is to ensure that the AER minimises the risk of understating the actual wholesale energy costs incurred by a retailer.

Conceptually we agree with the method undertaken by the AER's consultant, ACIL Allen (ACIL). The use of the 95th percentile of the simulated wholesale energy costs from its hedge model represents an appropriate approach to assessing risk.

We also note that the AER released a modified version of its models on 2 March 2020. We accept that ACIL use proprietary models and that there is a need for ACIL to protect their proprietary asset. We are currently reviewing the AER models but would expect they would include the outputs from the ACIL model runs such as the 49 demand profiles and the 539 simulated hourly spot prices. We believe these outputs would not require the disclosure of any propriety algorithm, techniques or formulae.

We believe that providing the model outputs would preserve ACIL's proprietary knowledge and would also provide a level of transparency of ACIL and AER calculations. This would allow stakeholders to provide more informed and objective responses which would add to the integrity of the DMO calculation over time.

Reliability and Emergency Reserve Trader (RERT)

The AER has proposed to use the RERT costs as published by AEMO for the 12-month period prior to the determination year. On this basis the AER has used the costs for 2018-19 as a proxy. These costs have been expressed based on energy consumption – which requires taking the reported cost in dollar terms from AEMO for the given region and prorating the cost across all consumers in the region on a consumption basis.

We seek confirmation from the AER that when setting the DMO for 2021-22 it will keep the current RERT value (i.e. $0.63) as the base and it will use the actual 2019-20 value as the estimate for 2021-22. This would ensure a more representative change in the RERT costs and consistency with the index method than if the $0.63 value for 2020-21 is adjusted to reflect more recent actual cost data.

We believe this approach should also apply to all other costs where actual costs for 2021-22 are not available such as for ancillary services.

Renewable Energy Costs

Origin supports the approach applied by ACIL with respect to renewable energy costs. We also consider that non-binding STP values do not properly capture the final binding STPs and are leading to estimates that are likely to be too low. For this reason, we support ACIL's decision to provide its own STP estimates for 2020 and 2021.

Network Costs

Given the timing of annual network tariff approvals for networks undergoing a revenue determination, the AER is unable to use approved network tariffs for Energex and SAPN for the purposes of DMO 2.

As a result, the AER proposes that changes in revenue are the best available information for network cost forecasts. However, we believe caution needs to be exercised under such an approach. Network tariffs are a function of revenue, forecast consumption, and revenue allocation across customer classes. We believe that the AER ought to take into account not only the change in revenue in 2020-21 for Energex and SAPN, but also the expected consumption levels and how the revenue is allocated to the different customer classes to ensure that it derives a more representative impact of changes in network charges for different customer classes.

Other Costs

The AER considers adjustments to the DMO are only justified in exceptional circumstances. It also states that it will place greater weight on information providing a transparent and factual representation of actual costs incurred by a retailer, and the proportionality of these costs, resulting from an exogenous change in the retailer's operating environment.

The AER applied this framework to the consideration of the costs of implementing five-minute settlement. However, the AER stated that 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 are disappointed with this decision as we consider the introduction of five-minute settlements will impose significant costs on retailers. We believe that the AER also has an obligation to determine a DMO price that does not understate a retailer's actual costs but gives retailers a reasonable opportunity to recover their efficient costs; which we consider the AER has not allowed for in this particular circumstance.

In this regard we would be happy to provide the AER additional information to address its concerns.

If you have any questions regarding this submission, please contact Sean Greenup in the first instance on (07) 3867 0620.

Yours sincerely

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