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Default Market Offer prices Options Paper on the methodology to be adopted for the 2022-23 determination (and subsequent years)

Meridian Energy Australia Pty Ltd and Powershop Australia Pty Ltd (**MEA Group or Powershop**) thanks the Australian Energy Regulator (**AER**) for the opportunity to provide comments on the AER's Default Market Offer prices Options Paper on the methodology to be adopted for the 2022-23 determination (and subsequent years) (the **Paper**).

Background on the MEA Group

MEA Group is a vertically integrated generator and retailer focused entirely on renewable generation. We opened our portfolio of generation assets with the Mt Millar Wind Farm in South Australia, followed by the Mt Mercer Wind Farm in Victoria. In early 2018 we acquired the Hume, Burrinjuck and Keepit hydroelectric power stations, further expanding our modes of generation. We have supplemented our asset portfolio by entering into a number of power purchase agreements with other renewable generators, and through this investment in new generation we have continued to support Australia's transition to renewable energy.

Powershop is an innovative retailer committed to providing low prices for customers and which recognises the benefits to customers in transitioning to a more distributed and renewable-based energy system. Over the last five years, Powershop has introduced several significant, innovative and customer-centric initiatives into the Victorian market, including the first mobile app that allows customers to monitor their usage, a peer-to-peer solar trading trial and a successful customer-led demand response program. Powershop has also been active in supporting community energy initiatives, including providing operational and market services for the community-owned Hepburn Wind Farm, supporting the Warburton hydro project, and working alongside our customers to fund a large range of community and social enterprise energy projects through our Your Community Energy program.

Statement

Powershop supports the review into the methodology of the DMO for application from 1 July 2022. Powershop agrees that the DMO has achieved the policy objectives it set out to achieve in 2019 and believe the broad prices struck for the DMO have reflected a fair and reasonable outcome for both customers and the industry.

Powershop supports the AER in a change from the indexation model (option 2 of the Paper) currently applied to a 'bottom up' approach (option 1 of the Paper). Powershop sees opportunity in option 1 to ensure that the final determination more accurately reflects the costs, especially with the changing wholesale costs incurred by retailers.

This change must also continue to uphold the policy of ensuring there is a reasonable margin and headroom applied in order for retailers to continue to invest in more innovatative products and services, creating greater competition for customers.

Subsequent to this sentiment, we agree the wholesale price calculation should be reviewed to correctly reflect changing market movements that have occurred over the last 2 years in particular. Powershop believes network costs should only be applied using approved final annual prices and not the estimated costs that would result in further inaccuracies in the final determined DMO.

Retail costs, profit margin and DMO allowance

Option 1 – Cost build-up

Under this potential option, Powershop believes the method could improve transparency and also rebalance any nominal margins. It could also encourage the AER to apply additional costs incurred by retailers currently not applied and as a consequence better reflect changes in those costs incurred.

However, as we have experienced under Victorian Default Offer since 2018, the AER would be subject to greater questioning of the estimates it would apply to each cost stack component and whether they can reflect underlying costs. There would also be a greater scrutiny on the estimations applied to the retail operating costs, retail margins, bad debts and the proposed allowance for competition and innovation to be embedded into the market.

Powershop also believes that if margins are reduced by moving to a cost build up method, this will restrict the ability to achieve the policy objectives of the DMO. Smaller retailers could be potentially restricted in their ability to further innovate and differentiate themselves in the market where they do not have the ability to absorb and rely on strong vertaincal integration models. This concern becomes more prevalent post the Energy Security Board's (**ESB**) post 2025 reforms.

Option 2 – Continue indexation

Powershop agrees that since the original DMO price was set using October 2018 market offers with variances in residual reflects the market conditions at that time, those market conditions may no longer be relevant. However, with this model delivering on the requirements of its policy objectives, we do not believe there is a strong basis or evidence to support a change to another methodology. The only action that could be required that would still ensure the objectives would be met is to amend the model to factor in relevant step changes since 2018, including a further consultation into the changing retail costs that have occurred (e.g. smart meters and market regulatory interventions of which have not yet been considered under a DMO). The consultation could confirm the method of identifying such costs and their materiality in a more granular manner in order to support this method.

Powershop does not support option 3 and reverts to the Australian Energy Council's submission.

Duration of the methodology

Powershop believes that a 3 year review window for the DMO is appropriate. The DMO will need to be adaptable and flexible to industry changes to the wholesale market. Innovation and transition to products and services that help address the projects the ESB is currently undertaking under its post 2025 program is essential, as is the headroom for retailers to be able to access to deliver on these projects. Without another review before 2025, the DMO potentially runs the risk of being irrelevant under a market, creating unecessary regulatory costs for retail business and in turn, customers.

Wholesale costs

Wholesale cost forecast – market based approach

Powershop supports the AER's review into various hedging strategies that retailers undertake. However, we caution the AER on assuming it will be able to conclude a firm position on what it may determine is a 'representative retailer' given the strong variances in those strategies.

Broadly, we hold concerns with the Wholesale Energy Cost (WEC) component and how the AER state how many MWs of swap a 'representative retailer' would purchase per MW of customer load, or the 'shape factor'. The Paper seems to be lacking this information so we believe the upcoming directions paper will provide stronger evidence of how the AER intend calculating MW swaps that reflect the correct market shape. Worryingly, the focus looks to be is on the average contract/forward price without acknowledgement that the average price shape has become more 'peaky' requiring a greater amount of swaps to cover 1 MW of average customer use.

Powershop refers to ACIL Allen's report that supported the final DMO3 decision[1]. In section 4.2.3, ACIL Allen acknowledge that the load is increasing in peakiness and they also acknowledge the increasing amount of solar PV in the system, and do project a further increase. The basis of their modelling relies on a combination of flat and peak swaps and caps but simultaneously acknowledge that the peak product is no longer a useful product to hedge, since solar has carved out so much of the peak 7am-11pm period.

Powershop believes the modelling for the price shape can be drastically improved for it currently does not take into account the difference in price shape the market has seen more recently, and have not factored this into their forecast. Further consultation will benefit the AER and industry.

Although it is true that there remains a high percentage of basic meters in AER states, using Net System Load Profiles (which does not distinguish between residential, business or solar) is appropriate. However, we know from the experience and data in Victoria, with almost 100% interval meters in place that the shape difference between residential and business (specifically residential customers peak in the morning/evening and business customers in the middle of the day between 9-5) is materially significant.

As the AER states continue to roll out interval meters (even for DMO customers) this same load shape differential will become evident within DMO4 and should be applied accordingly. ACIL incorrectly states that they will have the same shape. This view must change in this consultation and can no longer be held by ACIL for DMO4.

True-up network costs

Powershop would only support a DMO calcaultion that applies finalised network prices approved by the AER. Estimations of these prices for the 3 iterations of the DMO have proven inaccurate and have been inefficient to manage, particularly for the errors incurred in relation to the DMO for 2020 relating to Queensland and South Australia in 2020.

If you have any queries or would like to discuss any aspect of this submission please do not hesitate to contact me.

Yours sincerely,

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[1] ACIL Allen, Default Market Offer 2021-22, Wholesale energy and environment cost estimates for DMO3, Page 15