Government
of South Australia

Department for
Energy and Mining

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Gavin

Dear ~~Mr Fox~~

Default Market Offer prices - Issues Paper 2023/24 determination

The Energy and Technical Regulation Division (the Division) of the South Australian Department for Energy and Mining thanks you for the opportunity to comment on the Default Market Offer (DMO) prices - Issues Paper.

The South Australian Government is committed to reducing consumers' electricity bills and thanks the Australian Energy Regulator (the regulator) for its work in considering an appropriate methodology for adopting in the 2023/24 determination and beyond.

While we note the global supply crisis has increased electricity, and gas, prices to extraordinary levels, we expect the regulator will appropriately examine current and expected future market conditions to ensure consumers are not unfairly burdened by an excessive increase in the 2023/24 DMO.

The Commonwealth Budget forecasts that electricity prices will increase in the National Electricity Market by 20per cent by the end of this year and a further 30per cent next financial year – a potential cumulative increase of 56%. Price increases of this scale are completely unacceptable to the community and will have significant adverse impacts on households and businesses, worsening pressure on the cost-of-living crisis, reducing real disposable income and impacting economic growth.

We also share the regulator's concerns regarding higher retail prices leading to an escalation of consumers' debt levels, particularly for customers experiencing vulnerability. These customers may be less able to modify their energy use in response to higher prices or less likely to shop around for a cheaper energy contract. Noting that it is highly likely that any increase in the DMO will lead to subsequent increases in market offers for many consumers.

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The extraordinary volatility experienced in the wholesale market has been the main driver of recent price increases. As the wholesale cost component represents such a significant percentage of the DMO price, we expect the regulator to scrutinise these costs carefully.

Given current market conditions will inevitably lead to an increase in the DMO, and noting the regulator's consultants view that the current approach to wholesale cost forecasting had some potential to overestimate the wholesale energy cost, further refinement of the approach may be necessary to avoid unnecessary cost increases to consumers. The Division therefore supports amendments to the methodology that more closely reflect a retailer's actual exposure to increased wholesale costs based upon their contracted position.

Given the very low levels of liquidity in wholesale future contracts in South Australia, the proposal to include alternative sources of contract information into the regulator's book build process is supported to more accurately reflect costs that retailers face in South Australia, given the current methodology relies on a liquid contract market. As different retailers choose to manage risk through a number of different instruments, including power purchase agreements, physical ownership of generation, options or other types of derivatives, an approach which better reflects the real-world hedging behaviour of retailers, extending beyond ASX products, should be considered.

While this approach may add complexity in the determination of the DMO, and this is not ideal, it is preferred to excessive increases to consumer's electricity bills.

We also note the importance of creating a load profile which broadly represents both residential and small business customers as part of the wholesale methodology. Noting that the load profiles currently used are becoming increasingly peaky in shape, and that a peakier load profile is likely to result in higher hedging costs than a flatter load profile, the Division supports the regulator sourcing alternative load profile data from smart meters to test the appropriateness of the net system load profiles used. As the methodology is aiming to represent the hedging profile of a risk averse retailer, the more accurate data that can be sourced, the better.

Another possible change to the regulator's methodology could involve assessing the costs of a retailer's overall position in serving its entire customer base, rather than just their costs with respect to their small customer load. By including the consumption patterns of all customer types that a typical retailer would serve, i.e., by adding large customers, the regulator's assessment would capture any portfolio benefits associated with, what would likely be, a less-peaky load in aggregate. This approach could therefore capture any benefits and hedging cost efficiencies retailers receive from serving a diverse customer base, compared to a strategy of individually hedging against each separate customer type.

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With regard to retailer costs, and in particular smart meter costs, we support the regulator obtaining further information from retailers to better understand the extent to which they are recovering costs from customers via up-front fees. It is clear that these costs should not be over-recovered by retailers and therefore should not be subject of the DMO regulations. The 2022/23 DMO final determination acknowledged there is uncertainty in this space, and therefore a risk that the regulator's estimate of advanced meter costs may include a portion of ongoing costs that some retailers may recover through one-off fees. We anticipate that the regulator will obtain the required information to prevent this occurring in this determination.

As noted in the Energy and Technical Regulation Division's submission to the 2022/23 Draft Determination, the regulator's role specified under the regulations continually refers to consideration of prices, costs and profits *in that region*. This appears inconsistent with the approach taken by the regulator to apply a retailer margin consistent across all regions.

We remain of the view that it is an undesirable outcome for a universal margin to continue to be applied if this results in a higher DMO, which is expected to be the case this year. Some retailers have previously stated that retailer margins can vary by region for many reasons including risk, marketing strategy, and customer longevity and attempting to set a consistent margin can have adverse consequences for customers in some regions with little reference to the actual cost of serving standard offer customers.

As we argued in the last determination, the approach adopted by the regulator to set the retailer allowance as a proportion of the overall bill will result in larger retailer allowances if other DMO cost components increase. This effectively allows retailers to recover greater costs via standing offer customers for no justifiable reason, if other, non-retail related costs increase. All it does is further intensify price increases to consumers.

The previous determination noted that retailer margins for residential customers in South Australia were around 1 per cent. The 'glide path' approach adopted by the regulator in the 2022/23 determination led to a 6 per cent retail allowance for South Australian residential customers with no controlled load, or $110, and larger increases for other customer types. We consider a further increase to an 8 per cent retail margin, on a potentially larger DMO bill in 2023/24, is a significant increase for residential customers in South Australia without sufficient justification - noting that further increase to 10 per cent is planned for the next determination.

We do not consider this approach is appropriate given current market conditions, and certainly do not support any proposal to bring forward the 'glide path' to have retailer allowances of 10 per cent and 15 per cent in DMO 5 rather than DMO 6.

We note the regulator's issues paper mentions that retailers issued retailer of last resort (RoLR) notices during 2022 were not a result of the retail allowance or overall DMO price, but instead the business models adopted by these retailers. While we agree with the important

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objectives that retailers are to be allowed to recover their efficient costs, and that incentives for competition are to be maintained, we continue to note that allowing further margin within the DMO for competition to occur should be very carefully considered.

Finally, the Division supports further consideration by the regulator of extending the DMO price cap to embedded network customers of authorised retailers. However, the application of the DMO would need to consider that applying the full DMO to embedded network customers would mean that these customers are potentially paying twice for network charges, given existing charges from authorised retailers are for 'energy only' with the network component charged by the embedded network operator.

The Division thanks the regulator for the work on this important determination. Should you have any questions in relation to this submission, please contact Mr Chris Leverington, Senior Policy Officer, Energy and Technical Regulation Division, on (08) 8429 3298.

Yours sincerely

Vince Duffy
EXECUTIVE DIRECTOR
ENERGY AND TECHNICAL REGULATION

15/12/2022