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Mr Gavin Fox
General Manager (acting), Market Performance
Australian Energy Regulator
GPO Box 3131, Canberra ACT 2601

Via email to: DMO@aer.gov.au

Default market offer prices 2023–24 – Tango Energy Response to Issues Paper

Tango Energy thanks the Australian Energy Regulator ("AER") for the opportunity to make this submission on the issues paper for the default market offer ("DMO") prices for 2023-24.

Tango Energy is the wholly owned subsidiary retail arm of Pacific Hydro Australia (PHA). PHA was founded in 1992, and is a leading owner, operator and developer of renewable energy assets. It operates a high quality, diversified portfolio of wind, hydro and solar assets with an installed capacity of 665 MW; it also has a development pipeline of substantial projects totaling over 1100 MW of potential capacity, as well as over 300 MW of energy storage solutions.

We are a relatively new and growing retailer with approximately 150,000 small and large customers as of September 2022. While our customer base is predominantly in Victoria, Tango Energy also recently started selling to small customers in New South Wales, Queensland, and South Australia and expects to grow our presence in those jurisdictions.

Transparency and consistency in the application of the DMO methodology is increasingly important in a market that is facing high levels of volatility. The DMO methodology should encourage retailers to hedge in accordance with the published approach and have confidence in the consistency of the formula. A consistent formula brings stability to the retail market and retailers can then compete based on their retail service, brand, efficient operations, and innovation, and not on the level of speculation it has taken into its electricity hedging book.

As the AER are aware, there has been a clear impact on smaller and non-vertically integrated retailers as a result of volatile market prices and conditions, resulting in a number of Retailer of Last Resort ("ROLR") events. The lessening of competition results in less choice and innovation for consumers, in particular new entrant smaller retailers with a lower cost to serve that offer lower market prices critical to managing and lowering the cost of electricity to consumers, and managing hardship in a sustainable manner.

We acknowledge that energy price levels are part of a wider macroeconomic cost-of-living and inflationary issue faced in Australia, and are a pressing concern, and that regulators are expected to take action to protect consumers. The AER already has several more appropriate tools in place to achieve this such as its hardship program, price comparator websites such as Energy Made Easy, and has spent a substantive amount of resources on developing its energy equity program[1]. In addition, Governments can provide additional support to customers through various concession schemes and subsidy programs. It is therefore critical that the AER maintains consistency in the DMO methodology and avoids the temptation to implement

[1] https://www.aer.gov.au/retail-markets/guidelines-reviews/towards-energy-equity-a-strategy-for-an-inclusive-energy-market

short-term measures to modify the methodology to artificially deflate the DMO level in response to the current issues, as this would excacerbate the already significant volatility in the market. Further volatility in the market results in increased costs, which we detail further in this submission, and this comes ultimately at the expense of the long term interests of consumers who will face higher long-term costs. This would be inconsistent with the National Energy Objective.

Wholesale settings

In the previous DMO, Tango Energy stated that it disagreed with the AER's decision to move from the 95th percentile to the 75th percentile in determining hedged wholesale electricity costs[2]. We reiterate this position, and consider that in light of the price volatility and market events that occurred since the previous DMO was made in early 2022, this has further reinforced and demonstrated that a retailer that had been exposed to the level of spot price risk would have had significant and potentially unacceptable exposure to spot price outcomes. We suggest that ex-post modelling of price outcomes over 2022 be undertaken to confirm this position. Further, the recent rule change amending and doubling the Market Price Cap (MPC) on 1 December 2022[3] will result in greater volatility and exposure to a retailer and excacerbate the issue further. Overall, we consider that the continued assumption of a 75th percentile hedged position creates unnecessary downward bias and should be reviewed, with consideration given to whether moving back to a 95th percentile is more appropriate given recent market events.

As detailed in our confidential appendix, retailers are facing significantly increased hedging costs that are not being adequately reflected in the wholesale cost stack. We note that the AER considers that an efficient hedging strategy uses a 36 month horizon for hedging. This is challenging as there is significant uncertainty with respect to forecasting customer numbers accurately past 12 to 24 months. On the other hand, a prudent retailer hedging its book in 12 months faces substantially higher short-term hedging costs and is not allowed to adequately recover its increased hedging costs. We consider that greater focus should be on liquidity and availability of hedges; the current book-build approach assumes that a retailer-only entity would be able to obtain hedges at a favourable position, which is not necessarily a realistic assumption in times of significant price volatility.

The lack of consistency with respect to the DMO methodology adds to issues around forecasting exposure with certainty, and supports the need for a consistent DMO methodology to provide confidence to the market and subsequently lower the cost of hedging. The significant increase in cap prices also represents a new challenge to pricing methodologies, as the DMO does not allow for adequate recovery of hedging costs (which appear to be caused partly by the uncertainty around price-setting methodologies).

Indeed, we consider that a multi-year long-run marginal cost ("LRMC") approach over an extended time period (e.g. 5 years) may mitigate these issues – this is a proven approach, with the 5 year LRMC approach being an established methodology for distribution and transmission network determinations. Notwithstanding, this approach only works where there is low risk of political or regulatory intervention during the year-on-year price setting exercise.

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[2] https://www.aer.gov.au/system/files/Tango%20Energy%20-%20DMO%202022-23%20Draft%20determination%20submission%20-%2017%20March%202022.pdf

[3] https://www.aemc.gov.au/rule-changes/amending-administered-price-cap

Power purchase agreements ("PPA")

We do not consider that including PPA information in the cost stack is appropriate as the information would not be relevant, and would require substantial effort to obtain and synthesise for use in the cost stack. PPAs are effectively a swap, but given their bespoke nature, price in the negotiation of the terms and conditions and allocation of risk between counterparties, which differ between each contract due to the different negotiating positions of each party.

Furthermore, PPAs are generally not taken in support of a retail load due to the price base changing through the DMO on a yearly basis, and the frequent changes in price-setting methodology. Practically, this information would be difficult to obtain and standardise to analyse across large datasets, and is highly commercially sensitive requiring additional information controls. The benefit of obtaining this information does not appear to outweigh the costs.

Retail cost allowances

In our previous submissions we also stated that we did not agree with the cost stack approach. Again, we consider that the significant pricing events occurring after February 2022 illustrate and evidence the issues with cost-stacks, in particular the timing issues occurring from assuming a cost stack stays constant across the annual price period, and the necessary trade-offs with unnecessary administration and complexity of a DMO price that changes on a more frequent basis (e.g. every 3 months) to mitigate timing issues. For example, the market compensation events[4] occurring in 2022 will result in cashflow impacts on smaller retailers that are not reflected in a backward-looking price setting exercise. It is also worth noting that the recent Retailer Reliability Obligation T-1 instrument[5] made in South Australia will also add further costs to the wholesale cost stack.

Furthermore, and as discussed above, and in our confidential appendix, retailers are facing significant increases in underlying swap prices and in the cost of hedging that are not being adequately being reflected in the wholesale cost stack. These events collectively also result in an increase in cashflow risk that should be adequately reflected in the retail allowance. The increases in the costs of hedging are likely to be excacerbated by any further changes to DMO price setting methodology.

For these reasons, and for general good regulatory practice, we consider it is inappropriate to lower the retail allowance on the basis of prices (i.e. the denominator) being higher so that the retail allowance would be lowered to suit what appears to be a predetermined outcome. The idea of a consistent percentage retail allowance is that when prices are low, the absolute margin is low, and when prices are high, the absolute margin is high; in good times, a prudent business would reinvest cash and profits to save for a "rainy day" when prices and margin are low, or to innovate (e.g. invest in demand response programs) to provide better products and services to consumers in the medium to longer term. This is consistent with the generally accepted economy-wide practice of applying the Consumer Price Index ("CPI") percentage increase year-on-year to the cost of services (including Government Services)[6].

[4] https://www.aemc.gov.au/our-work/apc-claims

[5] https://www.aer.gov.au/node/74530

[6] https://www.esc.vic.gov.au/local-government/annual-council-rate-caps#:~:text=The%202022%2D23%20rate%20cap,Price%20Index%20(CPI)%20forecast.

Thank you again for the opportunity to provide comment and submissions on the DMO 2023-24. If you would like to discuss this submission, please contact me at the details provided with the submission.

Yours sincerely,

Shawn Tan
Manager, Compliance & Risk Management
Pacific Hydro Australia

Confidential Appendix

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