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Default Market Offer (DMO) prices 2023-24 - Draft determination

AGL welcomes this opportunity to provide comments on the Australian Energy Regulator's (AER) *Default Market Offer prices 2023-24 – Draft determination* (Draft determination) published on 15 March 2023.

AGL operates nationally across the energy supply chain and delivers 4.3 million gas, electricity, and telecommunications services to our residential, small and large business, and wholesale customers across Australia. We also operate Australia's largest electricity generation portfolio, with a generation capacity of over 11,000 MW, accounting for approximately 20% of the total generation in the National Electricity Market.

The AER has determined the 2023-24 DMO prices in the Draft Determination using a largely unchanged methodology from the 2022-23 DMO.

AGL strongly support this consistency in approach as making major methodology changes (including to mitigate the significant draft DMO price increases that are a result of current market conditions) would undermine the stated policy objectives of the DMO. It would also introduce uncertainty and expose retailers to greater regulatory risk with the subsequent impact on:

• future investment;

• participation in the competitive retail market; and

• potential retailer of last resort (ROLR) events.

AGL has supported the AER's market-based approach to forecasting wholesale energy cost (WEC) since the commencement of the DMO and continues to do so. However, AGL has significant concerns with the quality of the data inputs used in the WEC methodology for the 2023-24 Draft determination.

AGL believes the AER is:

• not using the most recent data available; and

• has not amended its data inputs appropriately to account for changing market conditions.

AGL's concern is that the data used in the AER's methodology is likely to underestimate the retailers' WEC for 2023-24.

The probability that the AER's modelling of WEC will be an underestimate has already increased significantly as the AER changed its methodology in 2022-23 to be based on the 75th percentile of modelled outcomes rather than the 95th percentile.

Further detailed comments in response to the Draft determination are included in Attachment A.

If you have any questions in relation to this submission, please contact Patrick Whish-Wilson on pwhish-wilson@agl.com.au.

Yours sincerely

Chris Streets
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Attachment A: AGL responses to Draft determination

Wholesale costs

AGL has generally supported ACIL Allen's consistent approach to forecasting wholesale energy costs (WEC) for the purposes of DMO prices. This is unchanged.

However, AGL believes it is now necessary to change the data used to determine load shape. The sheer volume of customers that have now installed solar PV (and typically switched to an interval meter as part of that process) means that the shape of the NSLP is materially different (and flatter) than the load profile facing retailers in reality. Accordingly, the use of the NSLP results in a DMO that materially underestimates the WEC.

AGL is proposing that the WEC calculation for the 2023-24 DMO prices should:

•   include interval meter data to determine load shapes rather than only relying on the Net System Load Profiles (NSLP) that are no longer reflective of a retailers' mix of customers; and

•   utilise up-to-date data where possible rather than relying on the 2018-2021 financial years. This would include 2022 demand and price data observations where they are accurate and verifiable.

AGL considers that the WEC determined for last year's DMO was a significant underestimate for reasons including the above point regarding load shape, the fact that future contract prices continuing to increase after the final determination of the WEC last year and the use of the 75th percentile (see below).

The change in WEC methodology last year to use the 75th percentile of model simulations rather than the 95th percentile significantly increased the risk of the modelling underestimating the WEC. This risk is exacerbated if the AER fails to ensure it uses the most up-to-date and accurate data available.

Load Shape

In previous DMO determinations, AGL supported the NSLP being used as the load profile for residential and small business customers when nearly all small customers were on basic meters. This is no longer the case and NSLP data is no longer representative of the total demand or load shape of mass market customers.

In its report[1], ACIL-Allen estimates that 30 per cent of meters are interval meters and therefore not included in the NSLP data. AGL' believes this estimate is conservative with interval meters currently making up almost half of AGL's customer portfolio across the states of South Australia, NSW and Queensland.

Accounting for interval meters is critical because interval meter customers are over-represented by solar customers with the corresponding peakier load shape.[2] For example, 43 per cent of AGL's customers with interval meters are solar customers while only 15 per cent of the customers included in the NSLP data have solar.

Combining interval and basic meter data therefore has a significant impact on the ratio of solar to non-solar customers and consequently, a representative load shape.

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[1] ACIL Allen, *Default Market Offer 2023-24: Wholesale energy and environment cost estimates for DMO 5 Draft Determination*, 23 Feb 2023 (ACIL Feb 2023 Report)

[2] ACIL Feb 2023 Report states (at p49): "*Between 2011-12 and 2019-20, the NSLP load profiles… experienced a carving out of load during daylight hours with the increased penetration of rooftop solar PV. This resulted in the load profile becoming peakier over time … the increase in solar output has greatly reduced prices during daylight hours which will increase the hedging costs for that region's NSLP … However, over the past few years the rate of carve out of the NSLPs has slowed and this is most likely due to new rooftop solar PV installations being paired with the installation of interval meters – removing those consumers from the NSLP. For this reason, we recommend data be obtained from AEMO for residential and small business customers on interval meters, to account for the load profile of residential and small business customers on interval meters,*".

Table 1 shows the share of solar customers in the NSLP data used by ACIL Allen compared with an estimate of the share of solar customers across all meters once interval meters are included. The differences are significant across all states.

Table 1: Percentage of solar customers, by meter type, state

State	Basic Meters		All Meters aggregated	
	Solar	Non-solar	Solar	Non-solar
NSW	6%	94%	21%	79%
QLD	23%	77%	38%	62%
SA	27%	73%	37%	63%
Total	**15%**	**85%**	**29%**	**71%**

Note: Controlled load data added to NSLP. For NSW, have combined all distribution zones.

A solar customer's load shape usually has a lower Average Demand and higher Maximum Demand so including interval meter data with the NSLP means the aggregated load profile in each state becomes peakier to reflect the greater number of solar customers.

This is highlighted by the following figures which compare an NSLP for each state versus an estimate of mass market load shape for each state using all meter data - combining the NSLP for basic meters with the interval meter data.

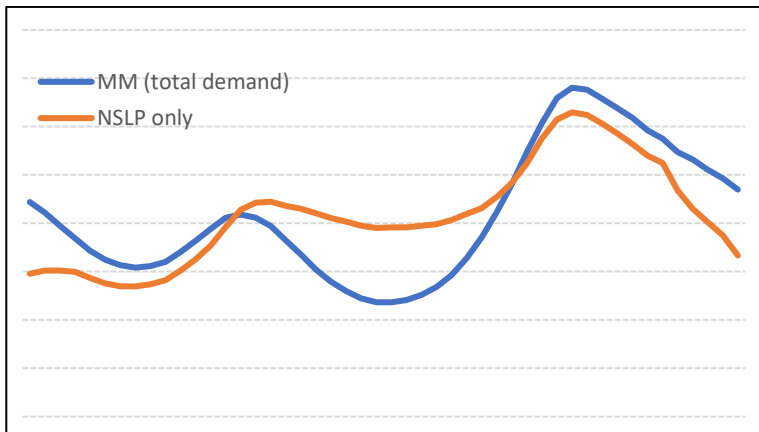**Figure 1: NSLP v Mass Market Load Profile, NSW**

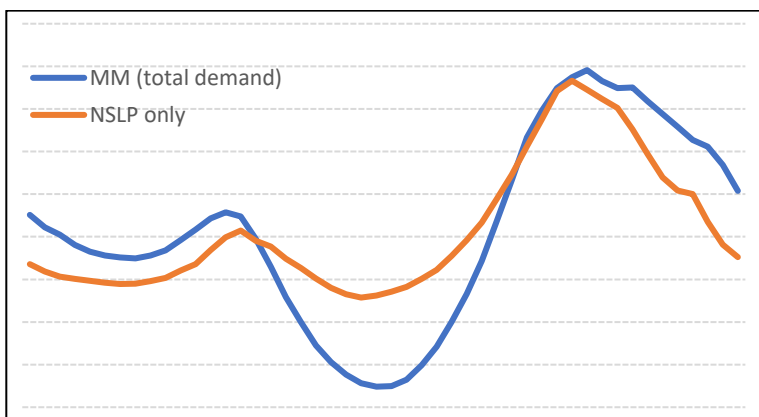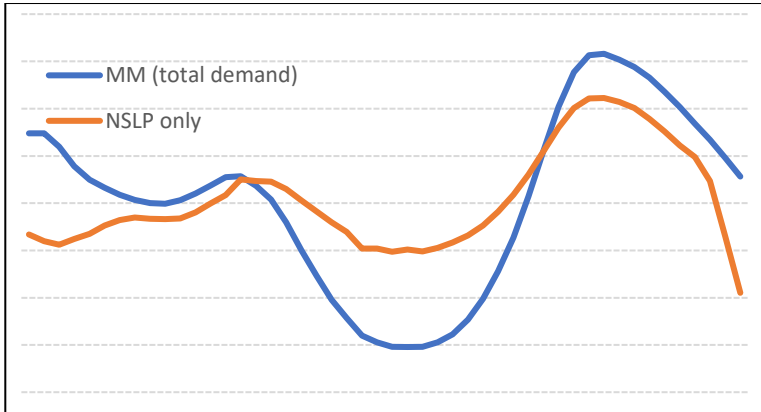**Figure 2: NSLP v Mass Market Load Profile, Queensland**

Figure 3: NSLP v Mass Market Load Profile, South Australia

Source: AGL analysis of NSLP and all meter data

The difference between the NSLP and estimated mass market load shapes in figures 1 to 3 are significant.

A consequence of the increase in peak demand and reduction in daytime minimum demand of the mass market load shape is that the cost of hedging will be higher than modelled for the NSLP in the DMO because of:

• the additional cap contracts needed to meet the higher peaks; and

• an increase in the absolute cost of hedging due to the reduction in average demand and consequent changes in the efficient mix of hedging products required.

This impact is likely exacerbated in 2023-24 because of the significant increase in future contract prices, including caps.

We note the AER has committed to exploring the use of interval meter data in the second half of 2023 and then implementing its approach in the 2024-25 DMO prices once impacts are understood.

AGL does not believe this is a matter for further exploration.

Given the penetration of interval meters and the different load shapes from that cohort of customers, the use of interval meter data is necessary in this year's DMO calculations in order to construct a load shape that is cost reflective for retailers.

We understand the interval meter data can readily be obtained from AEMO and AGL notes that ACIL Allen have already performed this process for the Queensland Competition Authority (QCA) who this year decided to incorporate interval meter data with the relevant NSLPs in their determination of regional energy prices in Queensland[3].The importance of this change can be implied when comparing the change in WEC for Queensland customers in the QCA's report[4] with the WEC change determined by the AER.

2022 Demand data

AGL recognises that ACIL Allen have used the 2018-19 to 2020-21 demand data set as the starting input for the 2023-24 determination because they have observed marked step changes in the data for Queensland and South Australia, following the introduction of 5MS in October 2021.

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[3] ACIL Allan, *Estimated Energy Costs, For use by the Queensland Competition Authority in its Draft Determination of 2023-24 retail electricity tariffs*, 15 Feb 2023

[4] Queensland Competition Authority, *Draft determination: Regulated retail electricity prices in regional Queensland 2023–24*, 15 Mar 2023

Although AGL understands ACIL Allen's predicament, the use of NSLP data, which excludes interval metering data, based on demand from the period 2018-19 to 2020-21 does not provide confidence for retailers who are hedging load in 2023-24. The load data used in the draft WEC is simply not reflective of the load shape likely to be faced by retailers in 2023-24.

AGL would encourage further analysis of the dataset with AEMO and believes this is further reason for the AER to direct ACIL Allen to utilise interval metering data in conjunction with the NSLPs in constructing the load shape for the 2023-24 DMO prices.

Spot Price volatility

Over the last 12 months, as highlighted by the AER, "*the wholesale market has faced unprecedented supply challenges and volatility[5]*".

AGL would therefore encourage ACIL Allen to demonstrate that their spot price modelling produces a range of outcomes reflective of reality, and in light of the spot price experiences of 2022-23.

We recognise the spot price model takes account of a large range of generator availability outcomes as well as changes to coal and gas prices but are unclear if these spot price outcomes adequately reflect the range of negative prices and sustained high prices that have been commonplace over the last 12 months.

AGL is aware that the impact of these spot prices on the ACIL Allen modelling simulations can be significant depending on their timing, the hedging strategy, and any net revenue impacts in the modelled scenarios.

Retail operating costs

In the Draft determination, the AER has continued to estimate retail operating costs by using:

•   ACCC 'retail and other costs' from the ACCC's November 2022 report, escalated by CPI;

•   advanced meter costs data provided by retailers; and

•   bad and doubtful debt costs as reported in 3 retailers' 2021–22 financial reports.

AGL has no concerns with this approach however it would highlight that AGL's bad and doubtful debt cost taken from its Annual Report is the total cost of bad debts for its electricity, gas and telecommunication customers.

It would be more relevant for the AER to use bad and doubtful debt figures from the ACCC retail cost data to derive a bad and doubtful debt as it pertains to electricity customers.

Retail allowance

AGL support the AER's decision to continue to use its established cost stack approach and apply the retail allowance as a percentage of total costs.

The AER has recognised the importance of the retail allowance being maintained and has focussed on achieving the key objectives of the DMO, including maintaining incentives for competition.

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[5] Australian Energy Regulator, *Default Market Offer prices 2023-24 – Draft determination*, 15 Mar 2023, page 3