AUSTRALIAN ENERGY REGULATOR

2024-25 Default Market Offer price determination

ISSUES PAPER PUBLIC FORUM

27 October 2023

The AER acknowledges the past, present and future Traditional Custodians and Elders of the nation we all meet on today. We recognise their continuing connection to the land, waters and community and the continuation of their cultural, spiritual and educational practices.

We pay our respects to them and extend that respect to any first nations peoples present in this forum today.

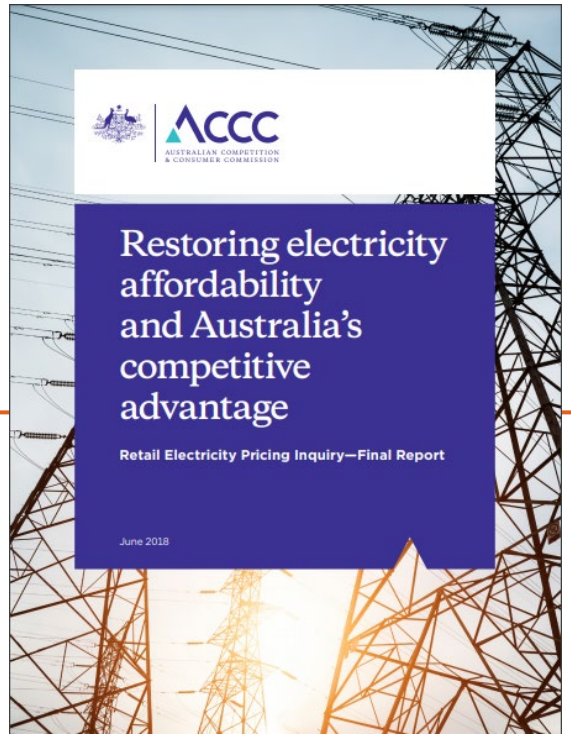
SLIDO ACCESS

We hope you can join in today's discussion and submit questions via Slido.

https://www.sli.do

Code: #2068666

DEFAULT MARKET OFFER RECAP

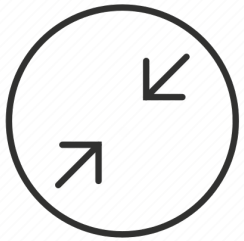


- The first Default market offer (DMO) came into effect on 1 July 2019. DMO policy came out of the ACCC's Retail Pricing Inquiry 2018.

- The DMO is the maximum price a retailer can charge a standing offer customer.
- The DMO sets a benchmark for market offers.
- The purpose of the DMO is to act as a fall-back for those consumers who are not engaged in the market.

DMO OBJECTIVES

The DMO price determination is set by the AER each year to:



Reduce unjustifiably high standing offer prices and continue to protect consumers from unreasonable prices

Allow retailers to recover their efficient costs of providing services, including a reasonable retail margin and costs associated with customer acquisition and retention

Enable and maintain incentives for competition, innovation and investment by retailers, and retain incentives for consumers to engage in the market

STANDING OFFER CUSTOMERS

In short, the DMO is a price cap that applies to residential and small business customers on standing offers in distribution regions where there is otherwise no price regulation, and whose standing offer is of a tariff type for which we determine a DMO price.

	DMO 5		DMO 4		DMO 3		DMO 2	
	Residential	Small Business	Residential	Small Business	Residential	Small Business	Residential	Small Business
	(No. and %) Q4 22/23	(No. and %) Q4 22/23	(No. and %) Q4 21/22	(No. and %) Q4 21/22	(No. and %) Q4 20/21	(No. and %) Q4 20/21	(No. and %) Q4 19/20	(No. and %) Q4 19/20
NSW	304,166 (9.0%)	53,467 17.4%	324,990 (9.7%)	57,016 (17.7%)	347,483 (10.4%)	64,211 (19.2%)	389,612 (11.8%)	73,346 (22.1%)
South East QLD	147,093 (9.8%)	21,820 (19.8%)	155,511 (10.5%)	20,885 (19.3%)	167,520 (11.5%)	24,234 (21.7%)	170,287 (11.9%)	25,062 (22.8%)
S.A	62,928 (7.8%)	14,611 (16.9%)	61,901 (7.7%)	13,289 (15.4%)	64,968 (8. 2%)	13,701 (15.6%)	64,968 (8.2%)	13,613 (15.5%)
Total	514,187 (9.0%)	89,898 (17.9%)	5425,402 (9.6%)	91,190 (17.7%)	580,519 (10.4%)	102,146 (19.2%)	624,867 (11.3%)	112,021 (21.2%)

We note that while the proportion of customers on standing offers has fluctuated in recent quarters the long-run trend is a steady decline in customers on standing offers.

MARKET DEVELOPMENTS

What we've noticed:

- Although decreasing from record highs, current contract prices remain higher than lower prices in 2020/2021.
- Current market offers indicate a greater level of medium and minimum market discounting from the previous year.
- Higher rate of returns and capital expenditure investments by networks to increase network costs.
- Increased uptake of solar PV systems impacting the peakiness of a retailer's load profile.
- AEMC's recent goal of universal uptake of advanced meters in the NEM to be a focus.

PRICE INCREASES

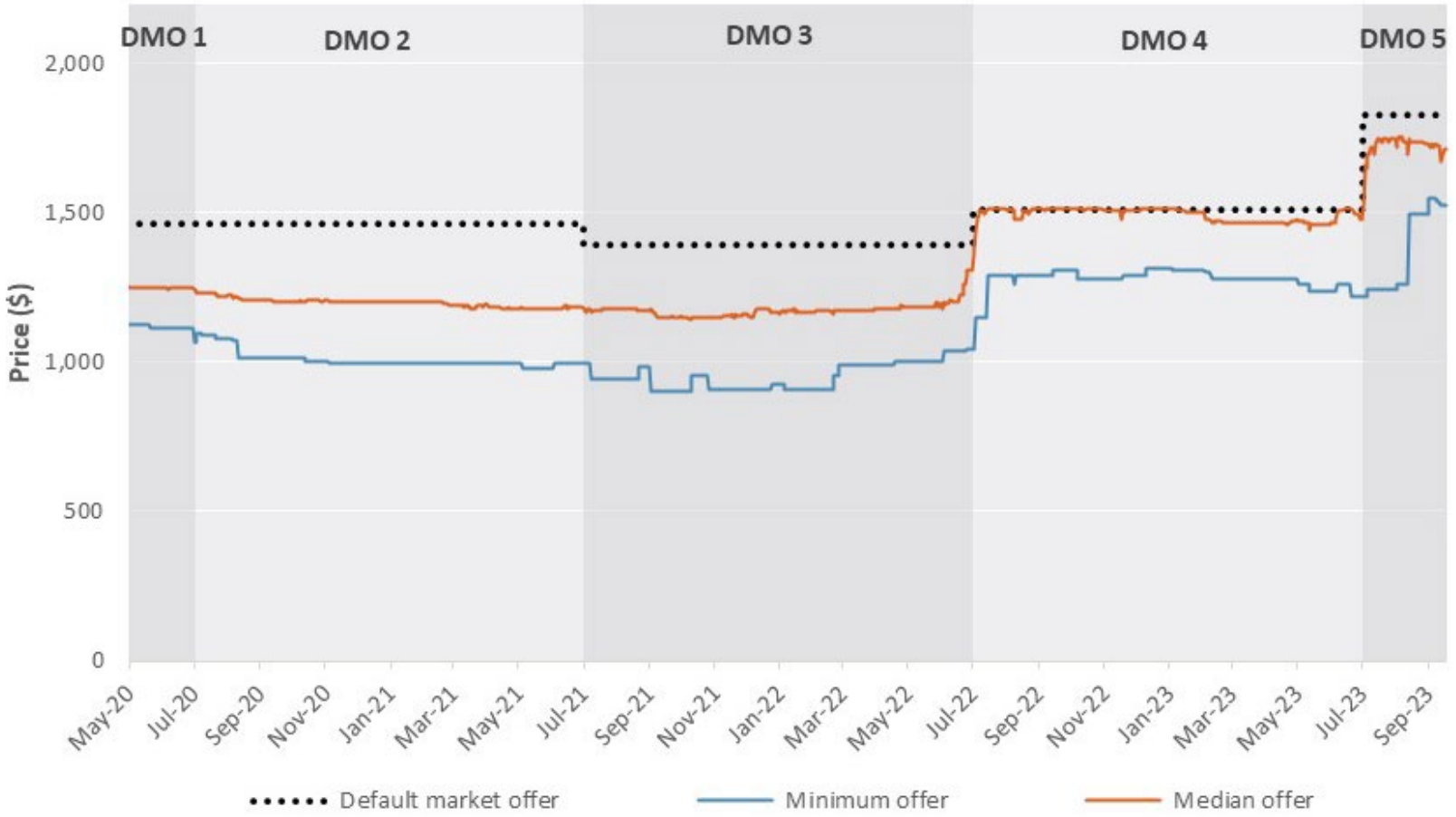
Residential market offers – DMO price, median and minimum market offer.

This chart is recent analysis that shows the median market offer, DMO price and lowest market offer.

In DMO 4 the DMO prices may have played less of a 'safety net' role - instead more closely represented a typical offer in the market.

We can see in the chart that there is a difference between the DMO 5 price and median market offer, with a similar market structure to earlier DMOs, however at higher price levels.

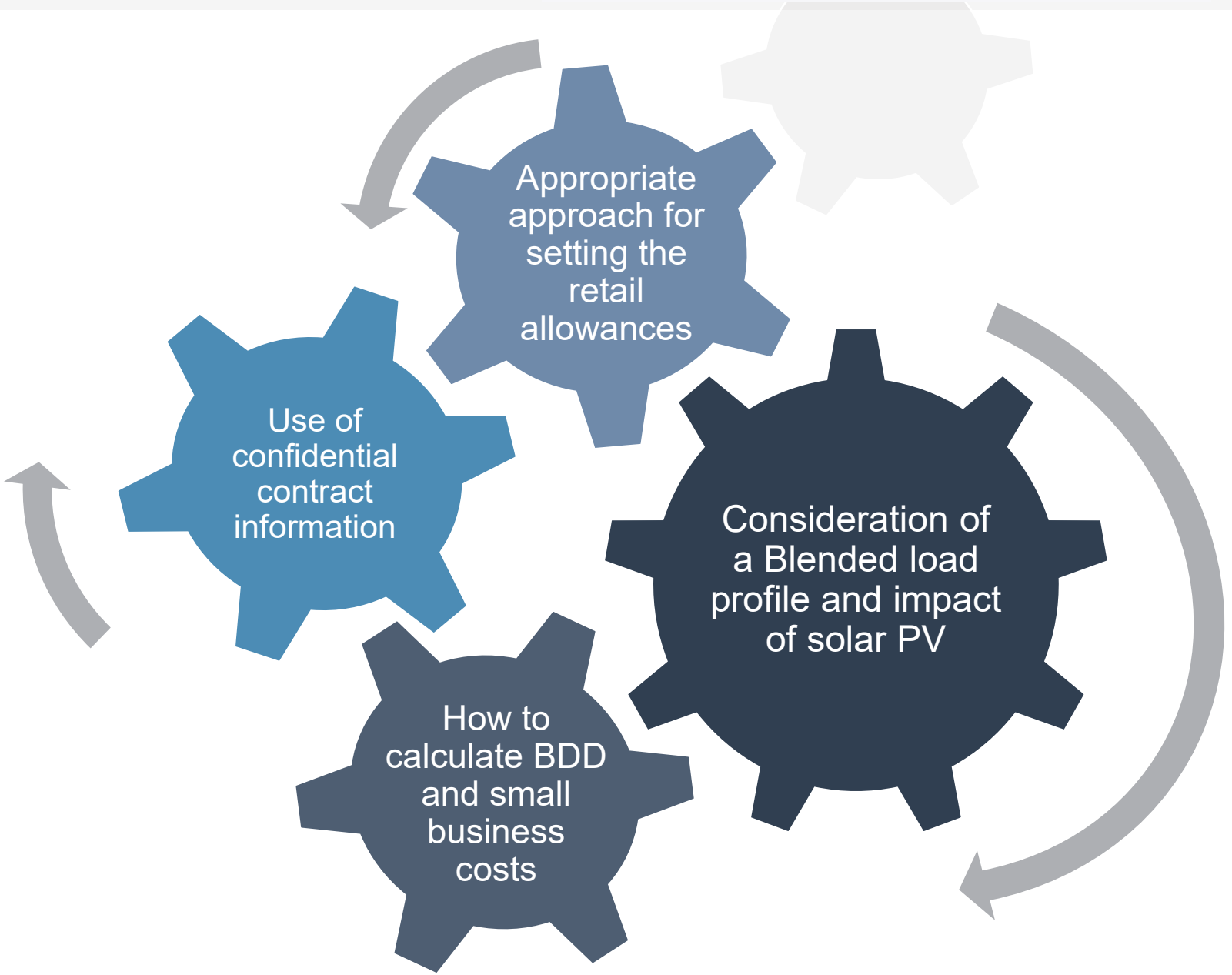
Ausgrid distribution zone in NSW, residential customers



DMO 5 ISSUES PAPER

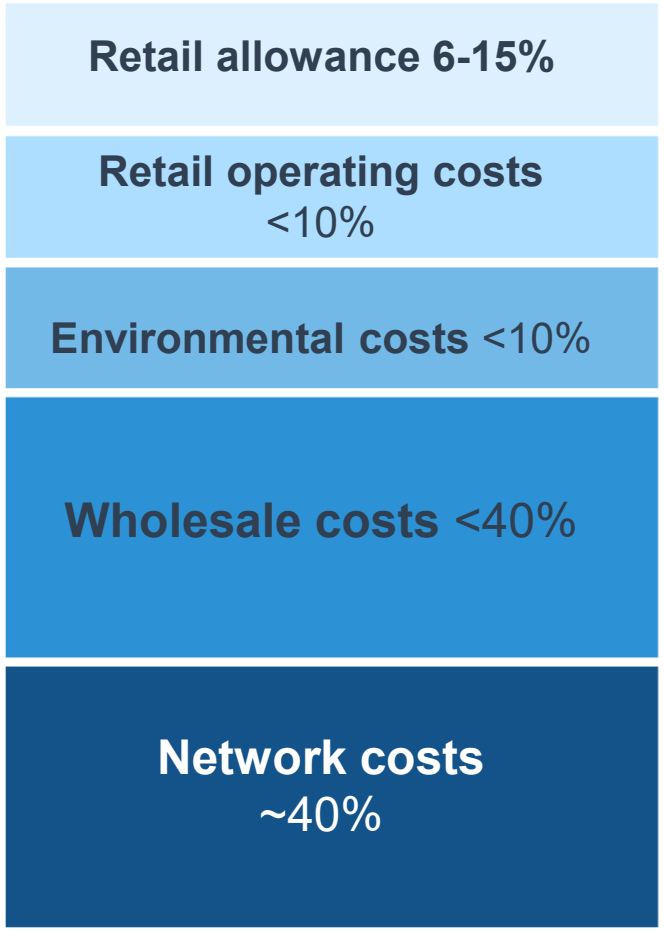
As outlined in the Issues Paper, for DMO 6 we are considering some changes to the current pricing methodology to ensure it continues to meet the policy objectives, in light of the market developments since DMO 5.

We particularly seek your views on various aspects of the current methodology



WHAT MAKES UP THE DMO PRICE?

We have a ‘cost-stack’ approach to determining DMO prices



– Fixed % of DMO price, which varies by region and customer type.

– ACCC data of actual retailer costs. Includes advertising costs

Forecasted values

This ‘cost-stack’ approach commenced In DMO 4.

Retail costs refresher

Retail operating costs + Bad and Doubtful Debt costs + Smart Meter costs

Retail operating costs

- ACCC data
- Weighted average of 15 retailers' costs
- Costs to serve
- Costs to acquire and retain
- $/customer for residential, c/kWh for small business

Bad and Doubtful debts

- ACCC data, not published but allowed available for us to consider and use.

Advanced meters

- Annual cost incurred for a smart meter
- AEMC smart meter review – accelerated rollout 2025-30
- costs significant in 2030 if there is 100% installation.
- ~$100/customer/year.
  - At ~25% uptake = $25 in DMO when smeared across all customers
  - ~$100 in 2030 DMO price if smart meter unit costs do not reduce.

How to calculate retail costs

Should we use weighted average retail costs? Or instead ‘Big 3’ or non-big 3 average?

Should we include an allowance for Costs to Acquire and Retain given there is also a competition element to the retail allowance?

- **No case:** DMO is a price cap on standing offers. Standing offer customers do not require acquiring and retaining
- **Yes case:** the DMO is also a reference price for market offers, which do include costs to acquire and retain customers.

Advanced meters

What is the best approach for cost recovery of advanced metering costs?

Should we project advanced meter installations instead of using historic data in future DMO decisions?

Retail Allowance refresher

It is set as a proportion of the overall DMO price in each region, rather than a fixed dollar figure.

An efficient margin PLUS an allowance for competition to meet the DMO objectives.

AER previous views:

- ~10% for residential customers
- ~15% small business customers

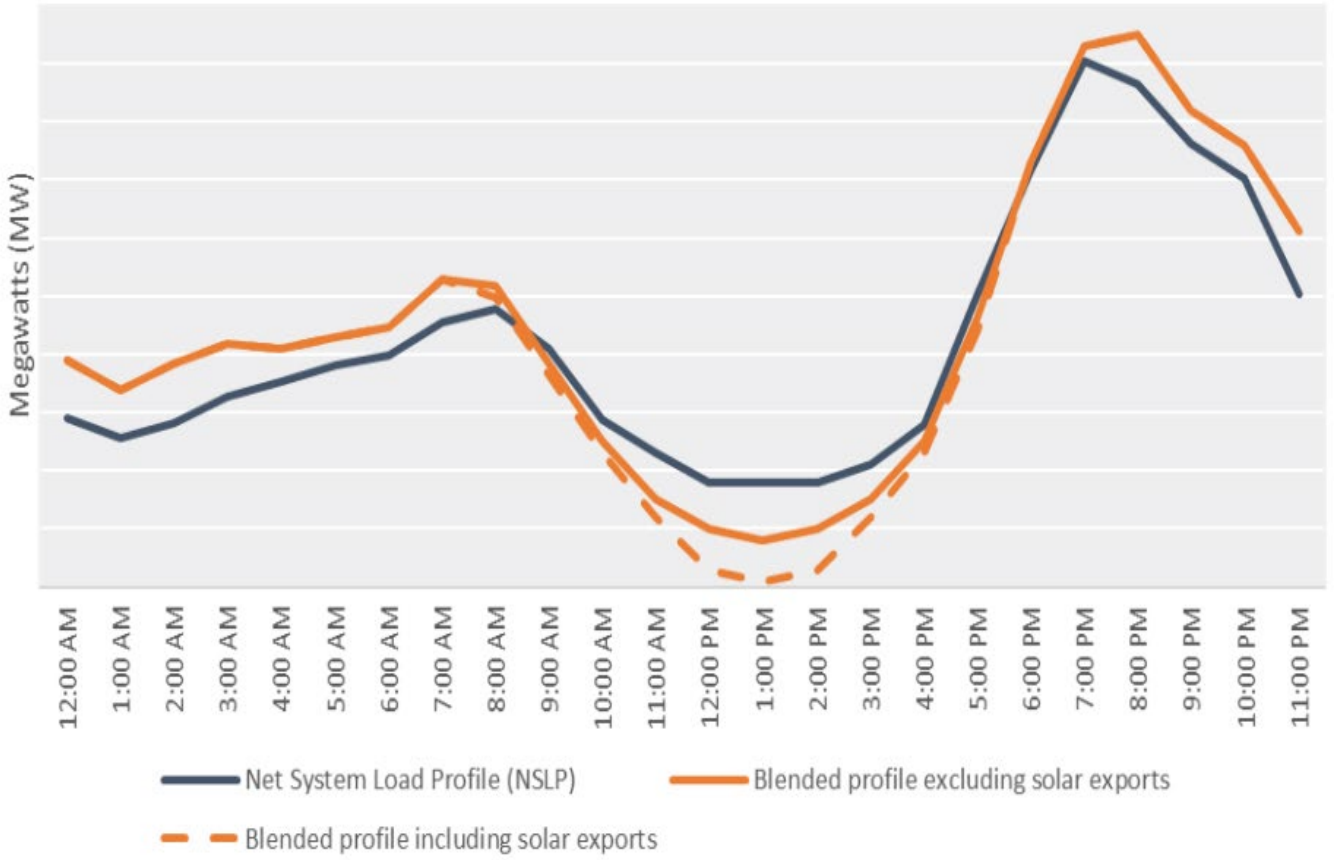
‘Efficient’ or ‘fair’ margins from other energy regulators – 3.9 to 5.3%.

ACCC measured margins in 21-22 at ~2.5%.

Retail Allowance

- The need for a methodological change to better balance the objectives.
  - Changing it to a fixed dollar amount.
- Changing it to have separate components (efficient margin (percentage based) + additional competition allowance)
  - Should it differ for residential and small business consumers?
  - Are there any risks or cost factors driving this difference?

Whether and how we incorporate advanced meter data into our estimated load profiles



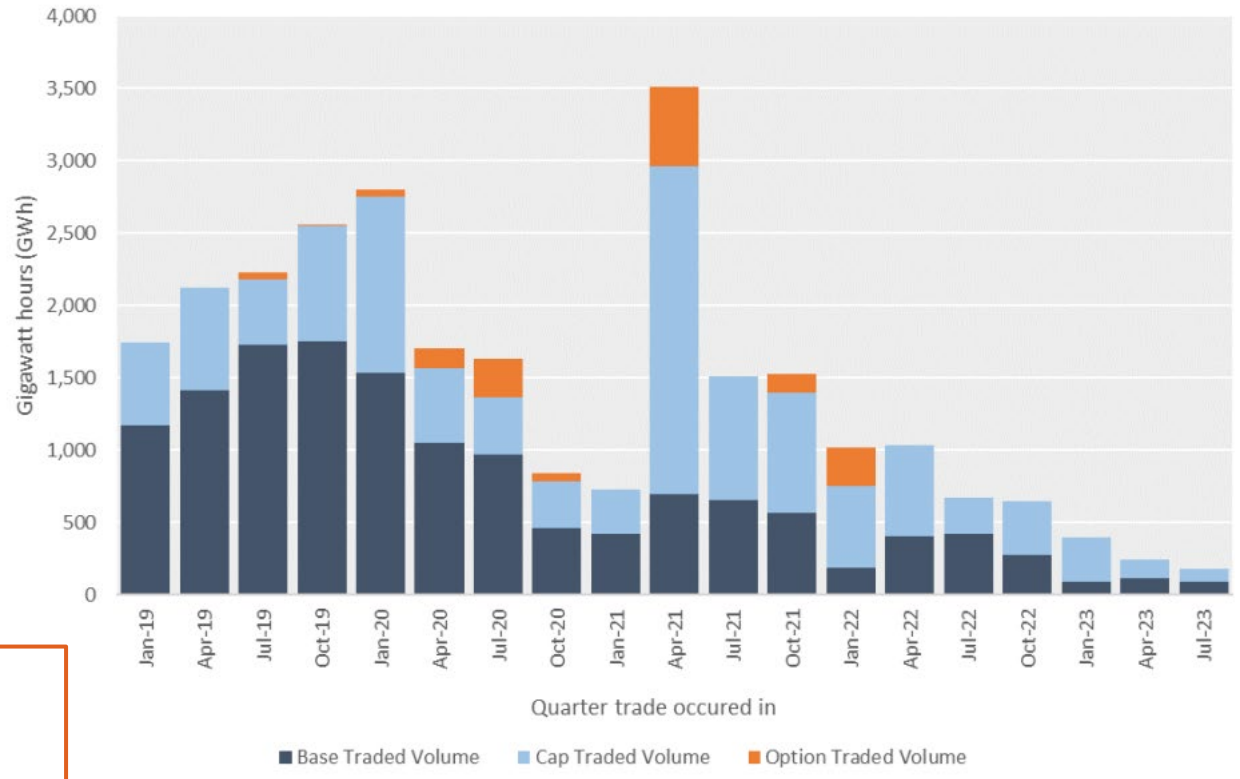
- Do we change our load profiles to include advance metering data and the impact of solar PV systems?
- How should we consider the impact of solar PV exports in determining load profiles?
- Is the increase in accuracy from the blended load profiles an appropriate trade off from the decrease in transparency?

Use of confidential contract information

- Due to decreasing liquidity, we're collecting OTC contracts to identify differences in the contract prices traded on the ASX and OTC.
- For SA we're also considering other strategies a prudent retailer could undertake to hedge against exposure to the spot price.

What other methodologies could the AER investigate to determine the wholesale cost in South Australia? Would a retailer holding Victorian futures contracts with SRAs be reflective of the practice of a reasonable retailer?

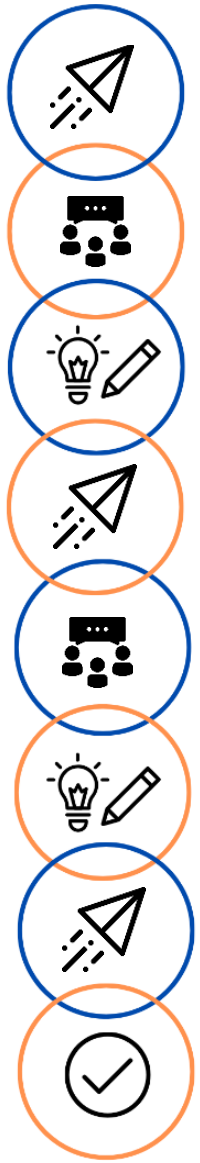
Figure 5 South Australia quarterly traded volume by contract type since 2019



Other issues in forecasting wholesale costs

- Changes to the coal and gas caps and how this impacts our modelling of estimated wholesale costs.
- Only including 'known' AEMO and AEMC compensation costs in the wholesale energy cost component.
- Whether we should include all available trades on the ASX in the calculation of the wholesale cost.
- Including exercised options and the upfront premium costs to determine the estimated wholesale costs.
- Maintaining the 75th percentile of wholesale cost estimates in our forecasting methodology.

WHATS NEXT?



5 October 2023
Publish DMO 6 issues paper

Late October 2023
Online stakeholder forum

3 November 2023
Submissions due

Early March 2024
Publish DMO 6 draft determination

Late March 2024
Online stakeholder forum

Early April 2024
Submissions due

Around 25 May 2024
Publish DMO 6 final determination

1 July 2024
DMO 6 applies

As you will see from this timeline, the issues paper marks the first of two rounds of public consultation in our annual DMO process.

We recognise stakeholders have a vast range of experience and insight to strengthen our determination.

As stakeholders often engage in different ways, we try to offer varied avenues for engagement – incl. **public forums**, **retailer workshops**, **one-on-one meetings with stakeholders**, **presentations.**

Submissions

Please email your submissions by 3 November:
DMO@aer.gov.au

Please feel free to reach out with any questions:
DMO@aer.gov.au

What we have ahead

- Origin Energy presentation (Sean Greenup)
- Business NSW presentation (Simon Moore)
- Q&A Session

We would really appreciate your feedback!