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3 November 2023

Gavin Fox
A/General Manager, Market Performance
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Dear Mr Fox

RE: Feedback on issues paper for the Default Market Offer price determination 2024-25

Please find below our submission to the questions raised in the issues paper for the Default Market Offer price determination for 2024-25

I confirm that the information contained in this submission is not confidential and may be made publicly available to facilitate an informed and transparent consultative process, with the exception of the confidential section highlighted in our response to questions 3 and 8 .

Yours sincerely



Adrian Merrick
Chief Executive Officer
Energy Locals Pty Ltd

SCHEDULE 1 RESPONSE TO QUESTIONS RAISED IN THE ISSUES PAPER FOR THE DEFAULT MARKET OFFER PRICE DETERMINATION 2024 – 25

Wholesale Costs

Question: 1 What approach should we take towards estimating load profiles? Should we retain profiles based on the NSLP and CLP, create blended profiles using the NSLP/CLP and advanced meter data, or take another approach towards estimating load profiles? Which is most reflective of a reasonable retailer's approach?

Response: Currently more than 30% of Australian households have rooftop PV. The current solar penetration rates coupled with the trend of larger solar systems and the speed of new solar installations warrants the specific inclusion of advanced meter shapes and a blended approach. In its June quarterly report, the Clean Energy Regulator (CER) noted that total added capacity for the year is tracking towards the current record of 3.2 GW set in 2021.

The specific solar shape has a significant impact on the overall net shape that a retailer supporting rooftop PV and the energy transition is left to hedge. The 'carve out' of load during the middle of the day severely limits the number of flat swaps a retailer can purchase before taking significant spot exposure. Additionally, peak swaps have a similar profile to a solar shape meaning they only compound the issue.

The wholesale market has had very little positive product innovation to assist with hedging the solar shape and is struggling to keep pace with solar penetration. In response to the 'carve out' we have seen an adjustment to load following hedge contracts that now typically set the volume of the hedge to zero in the event that the load of a trading interval is negative or net exporting. This is to maintain the generators' typical role of selling energy and not purchasing energy, meaning the retailer would simply be passing on the problem.

Without a hedging instrument, a retailer is now exposed to spot prices when/if they become a net generator for trading intervals. Specifically, they are paying the customer a fixed feed-in tariff (FIT) and receiving floating spot down to \$-1000/MWh.

Typically, it is smaller retailers that create competition through competitive market offers to grow their customer base. In their infancy, cashflow is a priority and they cannot fund feed in tariffs with negative spot outcomes, as the result would be lower FITs and less competition.

Question: 2 Is the lack of transparency of AEMO's advanced meter data a major issue for stakeholders? What information could we provide stakeholders to address issues with transparency of data?

Response: Smart meters continue to be rolled out, often because consumers are adding solar to their premises. Having access to advanced meter data would enable us to include it when determining load shape to develop our hedge strategy.

We strongly believe that the NSLP, CLP and the advanced meter shape should all be publicly available.

Question: 3 How should we consider the impact of solar PV exports in advanced meter data when estimating load profiles?

Response: The impact on the overall net shape the retailer must hedge, and the ability of a retailer to prudently manage the risk given the products readily available in the market, should be considered.

This should include the trend of increasing negative price periods in the market and their co-occurrence with the solar 'duck curve'. These events have the ability to create spot price exposure for retailers without significant storage or a commercial & industrial customer book to absorb the excess solar as they become a net generator for significant periods.

This means that the retailer is paying a fixed FIT and receiving a floating spot that is trending towards negative \$1000/MWh during the middle of the day. Whilst the AER does not set a minimum FIT, this component of the tariff is an essential part of the market dynamic as it provides consumers with a pricing signal and improves solar PV payback periods. We firmly believe that the cost of supporting the rooftop solar market should be formally recognised in the DMO.

An approach the AER might take could be to average the market FIT as an input to the DMO cost stack.

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Question: 4 Should the AER determine separate load profiles for residential and small business customers? Is this reflective of a prudent retailer's approach?

Response: We do not believe that it is required to have separate load profiles as we take a combined portfolio approach to hedging. Our belief is that this is a more efficient outcome in lieu of forecasting and hedging residential and small business load separately. It also reduces cost and capital requirements. Most hedge providers categorise residential and small business

customers jointly as 'small'. There is therefore little value in the DMO categorising them differently when hedge providers price them in the same way.

Question: 5 Should the AER have a singular profile for the entire NSW region instead of individual load profiles based on distribution zone? Is this reflective of a reasonable retailer's approach?

Response: We believe it is more efficient and reflective of actual approaches to have a singular profile.

Question 6: What additional data should we consider when assessing contract pricing for DMO 6, given the lack of liquidity in South Australia remains?

Response: We believe that the ASX remains pivotal to the wholesale market, and we are hopeful that, as we emerge from the recent energy crisis, the liquidity in the exchange will improve. We are buoyed by the introduction of Marex to ASX Clearing and believe we may see improved access to market and capital requirements.

We also support the AER obtaining OTC data as a reference point to the exchange results to act as a safeguard against any results that would produce an anomaly. However, we do not support the AER using this data as a basis for setting the DMO.

The issues we see with this are as follows:

1. It would include a large volume of internal transfers within vertically integrated participants, which we believe are not reflective of actual retailer hedge costs. These purely represent a transfer of earnings between departments of an organisation. A vertically integrated retailer can use this transfer price mechanism to move profit between business units to suit the narrative it wishes to portray to the market.
2. We would also be concerned that taking the focal point off the ASX as a point of reference for the DMO would further exacerbate the decline in the volume on the ASX. We believe it is imperative that the market has a deep, liquid, and transparent futures market as this would help drive down costs.
3. Using OTC data is not transparent and therefore a prudent retailer attempting to replicate the wholesale cost of the DMO could not mirror or track the forecast DMO outcome. Currently the underlying inputs are based on the ASX and therefore are observable and measurable. Unless the AER intends to release monthly/quarterly OTC findings it would be almost impossible for a retailer to benchmark their hedge book against the AER methodology. Keeping in step with the market wholesale costs is imperative in this competitive retail market.

Question 7: In the absence of sufficient exchange traded South Australian contract data, what other methodologies could the AER investigate to determine the wholesale cost in South Australia? Would consideration of a retailer holding Victorian futures contracts with SRAs be reflective of the practice of a reasonable retailer? How would we model this?

Response: We do not support the use of SRAs.

This is due to the following factors:

1. They are a non-firm instrument and, as such, their use infers a much greater risk appetite to the existing hedging instruments used to derive the wholesale cost. They

can create significant spot exposure which the AER cannot assume to be acceptable to the risk committees of market participants.

2. The limited availability of the product due to the size, tenure and pricing methodology does not make it a readily available and reliable hedging instrument.
3. The capital requirements of having to build a book of SRAs up to 3 years out for the prompt quarter lends itself to advantaging larger organisations with greater access to capital.

Question 8: Should we consider any other changes to the wholesale cost methodology considering a changing wholesale market?

Response: The liquidity of the wholesale market has been evolving, with the tenure of trades getting shorter. We believe this is driven by:

1. the increased capital cost and credit requirements when trading in the wholesale market. This has led to a focus on hedging prompt quarters;
2. the volatility in the wholesale market; and
3. commercial and industrial customers contracting for shorter periods.

We do not believe a 3-year time horizon is appropriate and would support a period 18-24 months which we believe is more reflective of reality. Any adjustment to the timeframe should consider the implication on the RRO and be mindful not to reduce liquidity, which could trigger another unnecessary and costly reliability instrument.

Longer hedge periods also expose retailers to significant cash requirements to service any mark-to-market cash calls.

In addition, the margin requirements should include the additional multiple of the ASX prescribed margins being charged by clearers.



There should also be an allowance for the cost of unaccounted for energy, which was introduced to the market last year to all retailers.

Retail Costs

Question 9: Do you consider these current methodologies used appropriate, and if not, what alternatives should be considered?

Response: We believe that the approach to establishing the retail costs is appropriate.

We recommend that the allowance for bad and doubtful debts should be adjusted to reflect the increased size of the average invoices and the expected economic climate over the coming 12 months.

The current methodology focuses on data available in the financial statements of large retailers, who are arguably less exposed to bad debts, as they have a large customer base which is more stable than that of a smaller retailer, where in many cases all customers have switched within the last few years. We know that switching leads to further customer churn, and churn is a key leading indicator of bad debt.

We encourage the AER to obtain confidential information from a larger number of retailers to obtain a representative sample of bad debt expenses.

We also note the additional requirements that retailers need to meet in order to manage customer debt in a compliant manner.

The AER also continues to increase its demands on retailers to support customers who are experiencing hardship or face natural disasters, etc. Whilst we agree that this support is necessary, we ask that the costs relating to this additional support be reflected in the retail allowance.

Advance Meters

Question10: Is the method for cost recovery of advanced metering costs appropriate for DMO 6 and/or future DMO decisions? If not, what alternative methods should the AER investigate to recover the cost of advanced meters?

Response: We note that the costs for advanced meters is currently not regulated and significantly contributes to the growth in costs to consumers. We encourage the AER to ensure that these costs are reasonable and regulated. We would be happy to provide the AER with further information on this matter.

Question 11: Should the AER project advanced meter installations instead of using historic data in future DMO decisions?

Response: We believe that the AER should use projected advanced meter installations to determine the cost allowance. This will eliminate the lag between retailers incurring the cost and cost recovery and the resulting cash impact. We believe that the information provided in quarterly performance reports will be sufficient for the AER to forecast the likely path of smart meter uptake in the coming financial year.

Question 12: What operational or cash flow considerations should the AER consider in determining the cost recovery of advanced metering costs? How do these considerations differ between large and small retailers?

Response: The cost recovery of advanced metering costs should include an allowance for the cost of capital. This cost is usually higher for small retailers who do not have the same access to capital markets as large retailers.

The mix of meter types should also be considered. Typically, metering providers will charge higher rates for non-metro installations, or for any type of meter other than a simple single

phase, single element one. Retailers are also charged for numerous other fees, such as if a metering provider claims an installation couldn't happen due to a customer not being present, or there being a dog on site.

Question 13: What operational and capital expenditure for advanced metering costs should the AER include in the costs recovered by retailers? Should these costs be subject to independent audit or review?

Response: As mentioned above we encourage the AER to subject the appropriateness of the metering costs to an independent review to ensure that consumers receive a fair deal. Metering costs vary considerable between States and Territories, and this is highlighted in border towns. For example, Metering costs are much more expensive in one part of Albury/Wodonga than the other.

Retailers facilitate meter exchanges, which drives up cost to serve materially during the year in which a customer chooses or needs to upgrade their meter. Retailers also carry the cost of the advanced meter exchanges for the period between installation and recovery from consumers, which at present would happen in the next annual tariff update.

Question 14: Are there methodological changes that would allow us to better balance the objectives in the retail allowance?

Response: We believe that the current methodology of setting a single retail allowance for all retailers favours the Tier 1 retailers who can absorb their fixed costs over a much larger customer base. This results in higher barriers to entry and less competition in the market from new entrants.

Small retailers can also rely less on brand recognition to gain sales, resulting in higher customer acquisition costs.

This has been acknowledged in the issues paper and we encourage the AER to reflect this in the DMO calculation.

Question 15: Should the retail allowance be a fixed dollar amount, and if so, why?

Response: The current methodology of applying a percentage to the cost stack to calculate the retail allowance results in higher allowances when prices are high and lower allowances when wholesale costs are low. Given that the wholesale costs only have a limited impact on the majority of retail costs, a fixed dollar amount is more appropriate and gives retailers more certainty.

Question 16: Alternatively, should the retail allowance be cast as separate components of efficient margin (percentage based) and additional competition allowance? How would these be calculated?

Response: We believe that this method will be unnecessarily complicated. The majority of retail costs relate to staff and billing costs, which are largely fixed in the short term.

Question 17: What components are missing from the retail allowance and why?

Response: We believe that the DMO methodology is now well established and covers the relevant components in the retail allowance.

Question 18: Should the retail allowance differ for residential and small business consumers? If so, what risk or cost factors drive this difference and how should this be calculated?

Response: The retail allowance is based on a percentage of the cost stack, which results in a higher allowance for businesses customers, which compensates retailers for the higher working capital, customer service requirements, and potential bad debt from small businesses.

Other DMO Cost

Question 19: Should network costs be based on a blend of flat rate and time of use network tariffs? If so, how should this blend be calculated?

Response: We believe that the current calculation method is reasonable.

Question 20: Does our proposed approach to determining a broadly representative time of use pattern remain appropriate?

Response: We agree the current approach is reasonable and should remain the same.