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03 November 2023

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

Submitted by email: **DMO@aer.gov.au**

Dear Mr Fox,

RE: Default Market Offer Price 2024-25 - Issue Paper

GloBird Energy (**GloBird**) welcomes the opportunity to provide feedback on the issue paper for the Default Market offer Price 2024-25 (**issue paper**).

GloBird commenced operation in 2015 and has steadily grown, currently retailing energy to over 200,000 residential and small business customers across Victoria, New South Wales, Queensland and South Australia. Our excellent value energy offerings, innovative products and a high-quality customer service are key drivers of our success in this highly competitive energy market.

In its DMO 5 issues paper the AER stated that the DMO policy objectives should:

- 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; and
- enable competition, innovation and investment by retailers, and retain incentives for consumers to engage in the market.

GloBird appreciates that the AER needs to find a balance between the above objectives when setting the DMO price. However, the current wholesale market condition and recent increase in ROLR events highlight the importance of the DMO allowing retailers to recover their costs as a means of protecting competition.

GloBird submissions provides feedback on the following questions raised in the issue paper:

WHOLESALE COSTS

95th percentile is an appropriate approach to estimate wholesale costs

In determining wholesale costs, the AER adopts a hedging strategy of a hypothetical prudent retailer, which progressively purchases hedging contracts.

A prudent retailer hedges based on credible stress tests. These are likely to be at or above the 95th percentile, especially when considering the long-tail skew of the cost distribution. Hedging to the 75th percentile would result in material exposure once every 4 years. In our view, this is not prudent. Given recent market conditions, it is arguable that even a 95th percentile approach would have likely been below actual costs. Further, given expectations of similar volatility through the energy transition, recent events may not

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represent a 1 in 20 year occurrence. GloBird recommends the AER undertakes a post-review of its modelled outcomes to determine the level of risks a retailer that did hedge at the 75th percentile would have faced.

We submit the use of the 95th percentile to estimate wholesale cost is more appropriate than the use of the 75th percentile.

12 -18 month is an appropriate book build period

The principle behind the timing of entering hedges is to link the timing with identification of exposure to risks. Therefore, we submit that the concept of "averaging in hedges" is inherently flawed.

Hedges should be put in place once an exposure to risk (in this case price) is identified. This occurs upon

(i) acquiring a customer and/or
(ii) repricing a customer.

An estimate of the time that the customer will be held and/or repriced is required to determine how far forward the associated price risk should be taken e.g.

(i) if churn is estimated at x% per annum then the total customer should be hedged accordingly i.e. reducing by x% each year; and/or
(ii) if regulation or market forces require customers' prices be reviewed on an annual basis, as is the case with standing offers, then a prudent retailer will hedge only for 12 months forward.

Should the AER continue with the progressive hedging approach then the following should be considered:

- Since the departure of several clearing parties from ASX energy futures, smaller retailers have not had access to this market. The pricing and hedging patterns on the ASX therefore reflect those of larger retailers only, not of the smaller retailers.
- Whether small retailers have access to ASX futures or OTC, they are less able to hedge as far forward due to the security capital requirements of ASX clearers and/or OTC counterparties.
- The AER's assumption of 3 year-forward hedging, and resultant pricing of the DMO, has in itself led retailers to hedge as far as is possible in this manner. This causes a circularity effect, whereby observations of contracting patterns will appear to support the 3-year assumption and lead, erroneously, to the conclusion that this is the manner in which a prudent retailers would choose to hedge.

We submit that 12-18 month book build period strikes the right balance between price stability, retail cost and sustainable market competitiveness.

Additional costs for smaller retailers

It is worth noting that smaller retailers pay a premium to the ASX price through their OTC contracts. Sometimes this is glaringly obvious when a contract transacted OTC can be seen to be immediately replicated on the ASX with the counterparty taking the margin.

Prescribing pricing based a 3-year hedge puts a material working capital burden on smaller retailers relative to larger retailers who have generation and/or low cost of capital. Therefore, a prudent small retailer would not hedge that far to avoid incurring additional costs that when passed to customers would jeopardise competition and reduce the availability of better value energy products to consumers.

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Feedback on other key wholesale cost questions

Question	Feedback
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?	Given the increasing number of advanced meter installations and the corresponding data used for settlement, we support the use of interval meter data alongside the NSLP in calculating wholesale costs. Such an approach will improve cost estimates.
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?	The trade-off is between transparency and accuracy. GloBird advocates for accuracy. Provision of data in aggregate form is appropriate in this instance.
Should the AER determine separate load profiles for residential and small business customers? Is this reflective of a prudent retailer's approach?	Residential customers have a much more extreme evening peak, where the wholesale price is much higher. In comparison, many small business customers close around 5 pm. Therefore, GloBird recommends that the AER determine separate load profiles for residential and small business customers.
What additional data should we consider when assessing contract pricing for DMO 6, given the lack of liquidity in South Australia remains?	We note the AER intention to collect OTC contract information from retailers and generators. GloBird encourages the AER to continue using this approach.

RETAIL ALLOWANCE

GloBird is concerned that there may be a call to reduce the retail allowance. Retail allowance is not a major component of the price stack and treating this component as a tool to reduce the DMO price will add further unmanageable risk to the retail market, increasing the likelihood that some small retailer will exit the market (ROLR or otherwise). In our view, such outcome contravenes with the DMO objective to enable competition and retain incentives for consumers to engage in the market.

GloBird Energy will be pleased to meet with the AER to further discuss this submission. Please contact Nabil Chemali via email: **nabil.chemali@globirdenergy.com.au**

Yours sincerely

John McCluskey
Executive Manager
GloBird Energy