3 November 2023

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

Submitted via email: DMO@aer.gov.au

Dear Mr. Fox

Australian Energy Regulator (AER) Default Market Offer (DMO) Prices 2024-25 Issues Paper

Thank-you for the opportunity to provide a submission in response to the Default Market Offer Prices 2024-25 Issues Paper (the **Paper**).

Momentum Energy Pty Ltd (**Momentum**, **our** or **we**) is an Australian operated energy retailer, owned by Hydro Tasmania, Australia's largest generator of renewable energy. We pride ourselves on providing competitive pricing, innovation and outstanding customer service to electricity consumers in Victoria, New South Wales, South Australia, Queensland, the ACT and on the Bass Strait Islands. We also retail natural gas to Victorian customers.

1. Summary

Retail energy businesses implement long term investment and strategic plans. These plans involve a review of the target market, together with understanding the regulatory framework in which the businesses will operate. A retailer's appropriate risk management controls are identified and implemented and form the basis for the ongoing success or otherwise of a retail energy business. It is paramount that this regulatory framework is relatively stable and predictable.

The past few years have seen significant volatility in wholesale market prices. From May 2022 to July 2023 seven electricity retailers failed, causing retailer of last resort events and several others temporarily withdrew sales and marketing activities in response to market events. This volatility undermined retail market confidence and certainty for both consumers and businesses.

The DMO was established as a price cap and an electricity benchmark price for consumers to compare price offers. It was based on a median price of market offers that factored in retailers' supply costs and allowed for a reasonable margin to support competition in the market, consistent with the DMO objectives. With the recent increases in wholesale electricity costs, Momentum is concerned that the retail allowance methodology is being heavily scrutinised and amended in a way that does not fairly reflect market conditions and

prevents retailers from recovering their costs in an attempt to address affordability for consumers. This inconsistent approach to determining the DMO each year is unforecastable, uncertain and does not appear to achieve the original purpose of the DMO. We urge the AER to avoid significant changes to the underlying inputs for determining the DMO each year and instead prioritise predictability and consistency in its approach.

2. Specific responses to questions raised in the Paper

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?

We understand the AER is considering the utilisation of a blended profile using the net system load profile (NSLP)/controlled load profile (CLP) and advanced metering for DMO 6. As the proportion of residential customers with advanced metering is approximately 35% across most jurisdictions, Momentum agrees that using basic meter data from NSLP and CLP does not accurately reflect the real shape of a retailer's small customer base. Incorporating a blended load profile will reflect the peakier load profiles of consumer solar generation and remove the transparency of the NSLP, which may result in increased cost to retailers to manage wholesale risk. While we understand that the AER has been working with their consultants to determine an estimated blended profile, we request consideration that this method be made public for retailers to estimate the blended profile to minimise the additional risk it will present.

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

Momentum is aware of the growing differences between the load profiles of residential and small business customers, particularly with the increased penetration of solar PV systems in the residential market. However, we believe that determining separate load profiles for small business and residential customers together with the introduction of a blended load profile will create excessive complexity for DMO 6. On this basis, we submit that separate load profiles for customer cohorts should not be considered in making the DMO 6 determination.

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

Momentum does not support the use of over the counter (OTC) trade data for the South Australian market as these are not indicative of many retailers hedge pricing. OTCs can present different credit risks and are often based on bespoke contractual terms. These factors can skew estimations of market pricing. Additionally, OTC trades are not transparent or able to be forecasted, which decreases a retailer's ability to manage wholesale price risk.

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?

Momentum does not believe Settlements Residue Auctions (SRAs) should be used to reflect the wholesale contracting practice of a reasonable retailer. The purchase of SRAs can be used as an option when South Australian contract hedges are not available or are too expensive. However, SRAs are uncertain for buyers as they are offered under a blind auction process, are a non-firm hedge (unlike a futures contract) and are less liquid in terms of ongoing hedge management. SRAs are exceedingly difficult to sell out of once purchased and are problematic to track and price. Therefore, using SRAs for the evaluation of wholesale costs for DMO purposes is inappropriate.

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

Options

Momentum has a concern with the usage of exercised options in the current wholesale methodology. Futures prices that result from exercised options should be omitted as currently all "winning" options futures prices get included. Hence, it assumes retailers know what the futures price will be in two or more years from now before they buy options over these contracts. As an alternative, Momentum suggests that the model should assume an average cost of option premiums paid, based on market observed implied volatility levels and assume a volume of hedge equal to the energy of the option's delta. This should be determined at the time the option is traded. This is likely to be a more reflective indication of a retailer's option hedge cost, rather than the current assumptions of counting 100% of the energy and prices of futures created from in-the-money options on expiry.

Cost of carry to fund Australian Securities Exchange (ASX) hedges.

An additional wholesale contract hedge cost that has arisen recently is the "cost of carry" to fund ASX hedge positions on the ASX. We believe the DMO does not factor in this cost. Due to increased interest rates in the market, higher ASX initial margin requirements, and increased futures prices (against which % based ASX initial margin deposits are calculated), the funding cost of holding ASX hedge positions has risen exponentially. As provided on the ASX Energy website, futures traders (retailers) are required to post up to 30% of the futures value in cash with their clearing participant for the life of the hedge. Some clearing participants require their hedge clients to post a significantly higher additional cash margin above this headline margin.

In 2020 and 2021, the cost of carry on futures hedges was negligible as interest rates were less and a relatively small initial margin deposit was required on lower priced futures contracts. As the DMO assumes retailers are hedging as soon as the futures trade, this

creates a significant additional hedge cost. For example, with a 20% initial margin requirement, a $100/MWh futures contract held for two years at a funding cost of 5% would give rise to a hedge funding cost of: 20% x $100/MWh x [$(1.05)^{2}$ -1] = $2.05/MWh. Momentum firmly believes that the DMO wholesale methodology should now include this additional cost of carry into DMO 6 and future DMO determinations if the current market arrangements continue.

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

Advanced metering costs

The current approach for determining advanced metering costs in the DMO has been manageable under retailers existing metering obligations for the provision of advanced metering. This has resulted in a metering allowance applied to the DMO price to cover the annual cost of a small number of advanced meters. However, under the proposed Australian Energy Market Commission's accelerated target for metering (expected to apply from 1 July 2025) the number of advanced meters to be installed by retailers each year will be determined by distributors, with yearly targets under a five-year plan. This will significantly increase the number of advanced meters to be installed by retailers negatively effecting cash flow. Compensation for advanced metering under the DMO price is not recovered until a full year of supply to a customer. Momentum suggests that the AER should adjust the advanced metering allowance in the DMO, prior to the effective year that the accelerated rollout is to commence. For example, if the accelerated rollout is to commence in 2025, then DMO 6 should include a cash flow metering allowance that covers at least fifty percent of the cost of the number of meters to be rolled out progressively throughout the following year. This will align a retailer's compensation for the cash flow cost of installing the advanced meters under the DMO's metering cost recovery method.

Small business costs

We understand the methodology for calculating the small business operating costs. However, with the increased assignment of Small Medium Enterprise customers to demand tariffs we are concerned that the averaged unit is not suitably applied to the relevant population of customers, which could result in the reduced dollar per customer allowance in DMO 6. We urge the AER to review this calculation.

Questions 14/15/16: Are there methodological changes that would allow us to better balance the objectives in the retail allowance?

Momentum supports the current approach of calculating the retail allowance as a percentage of the DMO price. We believe the established retail allowances of 10% residential and 15% small business are important to achieve the original intentions of the DMO. We understand why the AER chose to pause the retail allowance glidepath in DMO 5, due to the significant increase in wholesale prices, but we encourage its reinstatement to

ensure that all network sections are benchmarked by a DMO price that is sustainable and permits the competitive market to function effectively.

Furthermore, a reasonable retail allowance will cover:

- the depreciation and ammortisation of regulatory change costs that have recently been quite expensive. Recent system cost changes that have exceeded many initial budgets have included Consumer Data Right, Better Bills and the Australian Energy Market Operator's change to Five-Minute Settlement; and
- intra year cost changes to the DMO inputs, such as wholesale price changes, and pandemic impact/restrictions, which must be funded until the following annual DMO reset occurs.

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?

Momentum supports the continued approach of basing network costs on flat rate tariff prices for calculating the DMO network component in each distribution area. Moving away from this approach will increase complexity and provide less transparency for retail pricing.

We are hopeful that our comments above will help shape DMO 6 as well as future DMOs to ensure a fair and reasonable outcome for all market participants. Should you require any further information regarding this submission, please don't hesitate to contact me on 0478 401 097 or email randall.brown@momentum.com.au

Yours sincerely

[Signed]
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