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9 November 2023

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

Submitted electronically: [DMO@aer.gov.au](mailto:DMO@aer.gov.au)

Dear Mr Fox,

**Re: Default market offer 2024-25 Issues paper**

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to respond to the Australian Energy Regulator's (AER's) issues paper for the Default Market Offer to apply for the 2024/25 DMO period (or DMO 6). Red and Lumo recommend that the AER set DMO prices to reflect an appropriate balance of each of its pricing objectives. In practice, this means the DMO should continue to protect disengaged consumers from unjustifiably high prices, while also allowing retailers to earn a reasonable return that encourages competition and innovation. This view remains consistent with the Australian Consumer and Competition Commission's initial guidance about how default prices should be set.<sup>1</sup>

We acknowledge that some stakeholders will be looking to the AER to give more weight to protecting disengaged consumers from elevated prices rather than providing headroom for competition. This is due to the significant increase in energy prices in recent years and the challenges this is creating for some consumers. In particular, some consumer groups are recommending that the AER should reduce the retail allowance to an 'efficient' level and align it with other jurisdictions or to offset higher costs in other elements of the cost stack.

However, the retail allowance for the DMO will always be higher than other price regulated jurisdictions because it was always intended to be a reasonable price that reflects the operations of a broad range of competing retailers, rather than an efficient price. So we encourage the AER to continue to apply the pricing objectives in a balanced way. Any deviation

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<sup>1</sup><https://www.aer.gov.au/system/files/ACCC%20-%20AER%20Default%20Market%20Offer%20-%20Submission%20to%20Draft%20Determination%20-%202020%20March%202019.PDF> Page 1 - 2 "The ACCC considered that the DMO price should not be the lowest price, or close to the lowest price in the market, nor should it be set at an 'efficient' level. Rather its purpose is to act as a reasonable fall back position for those not engaged in the market for whatever reason or for those that require its additional protections, whilst also allowing scope for continued competition in retail offers."

from this in DMO jurisdictions will adversely impact retail competition to the detriment of energy consumers.

We have consistently argued that consumers are better off when they participate in the competitive market. This view is also implicit in many elements of the broader framework, including the use of the DMO as a common reference to assist price comparisons, extension of the Consumer Data Right to all retailers and the Better Bills Guideline, where the inclusion of a best offer calculation is intended to encourage a discussion between consumers and their retailer. The inclusion of an adequate allowance for competition and innovation in the DMO means consumers will benefit from that participation. At the same time, there are sufficient protections for consumers experiencing payment difficulties due to retailers' obligations to identify and then offer appropriate support.

Below, we comment on the specific aspects of both the wholesale and retail aspects of the DMO Issues paper.

### **Blended load profile**

Red and Lumo recommend the AER use more accurate information about costs and energy usage as it becomes available and where it clearly explains to stakeholders how it is using that information. This is a common theme across our recommendations for the calculation of wholesale costs.

Therefore, we support the use of a blended load profile that includes smart meter data as it more accurately reflects the load profile that retailers in DMO jurisdictions must manage. Given this, the AER should begin incorporating smart meter data into its DMO calculation of the load profile rather than relying on the current Net System Load Profile.

We acknowledge the AER's concerns about the transparency of this data. However, to the extent that it is possible, the AER should (with its consultants) make the data available for stakeholders to review and also explain any key assumptions. As a general rule, releasing the information on which a regulatory determination is based represents good regulatory practice and promotes confidence in and acceptance of the regulator's decisions.

### **Separate load profiles for distinct consumer segments and networks**

Red and Lumo support the use of separate load profiles for residential and small business consumers. These are distinct consumer segments with different load profiles. For example, many small businesses do not have solar PV installed and they operate during the day mostly using energy at different times to residential consumers. Accordingly, we support different

profiles for residential and small business consumers on the basis that it more closely reflects real world outcomes. Similarly, Red and Lumo recommend that the AER calculate different load profiles for each of the three electricity distribution networks in NSW in light of their significant differences in population density, mix of consumer segments and nature of economic activity.

### **Use of confidential contract information**

Red and Lumo's preference is for the AER to continue to rely on publicly available ASX data when calculating wholesale costs. However, we acknowledge the need for the AER to collect confidential over-the-counter contract (OTC) data for base, peak and cap contracts to understand whether there are material differences in hedging costs. However, our support for the use of OTC contract information is subject to some critical conditions.

First, the AER must be transparent about the way in which it uses OTC data. This openness will assist in gaining stakeholders' confidence and acceptance of the regulator's decisions. Second, it is important that the AER use a common sampling period when comparing OTC data with ASX data. For example, a comparison of trades between OTC and ASX data on different days would not be appropriate, noting the sometimes significant differences in load profiles.

Finally, the AER must ensure that the data collection process for on OTC data is streamlined and minimises the administrative burden for market participants as much as possible.

### **Other methodologies to determine the wholesale costs in South Australia**

As noted, Red and Lumo's preference is for the AER to use publicly available ASX data to price futures contracts for base, peak and cap contracts in South Australia, with appropriate cross checking against OTC data. We understand that the AER has some market liquidity concerns in South Australia but this would still be the best option to represent a prudent retailer's hedging costs.

However, we do acknowledge there are market participants in SA who hedge against the spot price by purchasing a mix of Victorian and South Australian base, peak and cap contracts and using Settlements Residue Auctions (SRAs) to access inter-regional settlement residues. As we understand it, these market players are adopting this strategy as part of a broader portfolio approach which incorporates other hedging strategies.

Importantly, we do not support this approach. SRAs that are calculated on the basis of inter-regional transmission over regulated interconnectors and settlement transactions between regions do not represent a complete hedge and are not without risk. In practice, market participants who bid on those SRAs will never really be able to accurately forecast both the SRA

value and the inter regional flows over the interconnector. As a result, SRAs can never be considered to be a reliable hedge.

We therefore consider that there is a risk to a retailer that uses a mix of Victorian and South Australian base, peak and cap contracts with SRAs to hedge against exposure to the SA spot price. If the AER incorporates such a strategy into a prudent retailer's hedging strategy it would need to build an appropriate risk margin into the hedging price. Of course, the margin should reflect the nature of the risk, which in our view would be significant.

### **Retail allowance**

Red and Lumo view the AER's established methodology for setting the retail allowance, including margin, as consistent with a reasonable approach and we see little reason for substantial change. The current retail margins strike the right balance between the DMO objectives by protecting against unjustifiably high prices for standing offer consumers while allowing retailers to recover a reasonable margin while allowing scope for continued competition.

The AER will be aware of the numerous market offers below the DMO. This suggests the AER is achieving the right balance of policy objectives and creating opportunities for consumers to benefit from participating in the competitive market. This is most notable in NSW rather than in south east Queensland and SA, where the AER paused the glidepath towards a reasonable retail margin in its most recent determination. In these latter jurisdictions, the difference between the median market offer and DMO is smaller than in NSW.

As a general point, it is clear that returns to retail operations have not been excessive in recent years. Rather, there is evidence of consolidation and exit, the gap between the DMO and market offers has narrowed since the initial years of the DMO and some retailers have withdrawn offers to specific consumer segments. This coincides with a period of higher borrowing costs and the cost of implementing significant regulatory initiatives such as the Consumer Data Right and Better Bills Guideline.

As such, we see little reason for substantial changes to this component of the DMO, such as a shift to a fixed dollar amount. This would clearly impact some retailers negatively compared to others, noting differences in cost structures for large and small retailers (to which the AER refers). Accordingly, we see significant risks for competition if the AER shifted to this approach. Similarly, the separation of the margin into 'efficient' and 'additional competition' components has no precedent and would provoke discussions about what a reasonable level for each would involve.

## **Timing of network cost recovery**

The AER must ensure that the DMO team works closely with its network pricing team to coordinate their respective determinations and that the final DMO accurately reflects the network costs that retailers will face during 2024/25. This includes any network incentive schemes. Furthermore, retailers need adequate lead time to develop their pricing strategies, finalise their retail service offerings and provide notice of price changes to their customers in line with regulatory obligations and consumer expectations

## **Metering**

The proposal to accelerate the deployment of smart meters to achieve 100% penetration by 2030 means the AER will need to carefully consider the timing and volume of retailers' metering costs. Retailers will incur additional (and significant) costs—through the installation of new meters and from the removal of meters that still have some residual life. The AER will want to avoid price spikes for consumers from the acceleration of smart meter installation, while also allowing retailers to recover costs in the DMO periods in which they are incurred. In this regard, we consider:

- Historical rates of smart meter installation will not be a guide for future rates.
- Advanced metering costs should be recovered on a cost reflective basis each year from 1 July 2025 to 30 June 2030. Retailers will be required to roll out these advanced meters incurring large costs which they should be entitled to recover in a timely manner.
- The AER should introduce an unders/over account for advanced metering cost recovery from 2025- 2029, noting that there may be practical obstacles to achieving forecast rates of installation that are outside retailers' direct control. An example might be weather conditions. This would allow retailers to recover their efficient advanced metering costs while protecting consumers from any over recovery. When operational, the AER would require retailers to apply the unders/over account in a symmetric way making adjustments for any under/overs relative to forecasts.
- Retailers should be entitled to recover any borrowing costs associated with the installation of smart meters that they forecast every year from 2025/29. This is because there will be timing differences between incurring the costs of these meters and their recovery from consumers. In practice, they should be entitled to recover the time value of money for at least 1 year for both their capital and operational costs of their accelerated metering investments that they have forecast every year between 2025/30.
- Retailers should be able to recover both direct and indirect costs in the calculation of advanced metering costs. This is consistent with how any business operates. For example, we anticipate a significant contribution to cost to serve arising from the smart meter mandate in addition to the direct costs of installation. We will need to explain the rationale for the replacement of a functioning meter, explain the additional services that a

smart meter offers, discuss the more complicated pricing that a smart meter will enable, and offer advice to consumers who may need to incur additional costs to remediate a site (by removing asbestos, for example). We will also need to manage consumers who object to the installation of a smart meter.

- Retailers should be entitled to recover the costs of the accelerated cost recovery of accumulation meters that is being proposed by the DNSPs in their rate reviews. We expect that all of the DNSPs in DMO jurisdictions will accelerate their cost recovery of the accumulation meters in their next regulatory periods. Apart from NSW—where the distribution networks begin to recover these costs from 1 July 2024—we expect that we will be able to pass these costs on from 1 July 2025.

### **About Red and Lumo**

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales, Queensland, South Australia and in the ACT to over 1.3 million customers.

We thank the AER for the opportunity to respond to its issues paper. Should you wish to discuss aspects of this submission or have any further enquiries, please contact Con Noutso, Regulatory Manager on 0481 013 988.

Yours sincerely

A handwritten signature in black ink, appearing to read "G. Hargreaves".

**Geoff Hargreaves**

Manager - Regulatory Affairs

**Red Energy Pty Ltd**

**Lumo Energy (Australia) Pty Ltd**