Government of South Australia

Department for Energy and Mining

Our Ref: 2023D087777

Mr Gavin Fox
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Dear Mr ~~Fox~~ Gavin

Default Market Offer prices - Issues Paper 2024/25 determination

The Energy and Technical Regulation Division (the Division) of the South Australian Department for Energy and Mining thanks you for the opportunity to comment on the Default Market Offer (DMO) prices - Issues Paper.

The South Australian Government remains committed to reducing consumers' electricity bills and thanks the Australian Energy Regulator (the regulator) for its work in considering an appropriate methodology for adopting in the 2024/25 DMO determination and beyond.

With electricity, and gas, prices having risen to extraordinary levels in recent times, we expect the regulator to appropriately examine current and expected future market conditions to ensure price relief is delivered to consumers in the 2024/25 DMO.

While the Government's Energy Bill Relief package helped address the immediate impact on Australian households and small businesses, it is expected that the regulator will factor the significant impact the recent cost increases have had on consumers to provide customers with further bill relief when considering the next DMO. It is important to remember, these increases have occurred at a time of ongoing interest rate rises and broader cost of living pressures.

Noting the lag in reporting of data, South Australian residential customers in retailer hardship plans had already increased over 10 per cent from Q1 to Q3 2022/23, while the number of residential customers repaying energy debt increased by over 23 per cent. Importantly, these figures do not account for the likely substantial spike following the most recent DMO increase (in Q1 2023/24), and associated increases in market offers. It is also likely the Government's Energy Bill Relief package prevented these figures being even higher.

The Division therefore echoes the concerns of the regulator about the impact of increasing market offers on consumers and consumer debt levels, which highlights the importance of the DMO in protecting consumers from unjustifiably high prices.

The Division notes the significant increases of 2023/24 and considers the recent decreases in wholesale prices should lead to a more reasonable DMO outcome, and associated retail market offer prices, in 2024/25.

As revealed by the regulator's recent Wholesale Markets Quarterly Report, average wholesale electricity prices in the National Electricity Market were less than half that seen at the same time last year. Analysis undertaken by the Division shows that both average and peak spot prices in South Australia this calendar year are around half of the average from the same time last year (January-October 2022).

While it is noted that expensive hedge contracts that were traded before the government intervened in coal and gas prices will be included in the 2024/25 DMO methodology, the subsequent fall in prices should be reflected in the regulator's determination to the benefit of consumers. The Division has found that ASX futures for the 2024/25 period were below where they were in the last financial year for South Australia. This was supported by the regulator's findings that base futures prices fell between 32 and 36 per cent compared with the highs in October 2022. The Wholesale Markets Quarterly Report also found that forward prices fell for Q4 2023 and 2024, likely reflecting the impact of mild spot price outcomes this quarter on price expectations for the near future, while base futures prices for 2025 remained steady.

With regard to retail market prices, we note the regulator's statement that the DMO price and the median market offer have converged over DMO 4 and 5, but that recent analysis has revealed that the number of market offers at or below the DMO has increased. We hope this may indicate that retailers have recovered from the volatility that occurred in late 2022, and that there may be scope for a reduced DMO in 2024/25.

The Division also wishes to respond to some of the specific matters raised by the regulator's Issues Paper.

Firstly, the Division notes the regulator's desire to reconsider the retail allowance in DMO 6 and adopt an approach that best meets the DMO objectives. These objectives allow retailers to recover efficient costs and a reasonable margin, aim to reduce high prices to protect consumers and should enable competition, innovation and investment by retailers, while retaining incentives for consumers to engage in the market. We understand the inherent tension between these objectives that the regulator highlights.

While balancing these competing objectives is difficult, the Division considers that, given the unprecedented DMO increases in the past year, along with other cost of living increases, consumers should not need any more incentive to engage in the market than they already have. AEMO data from September 2023 shows that monthly small consumer transfers spiked in the second half of 2022, aligning with extraordinary conditions in the energy markets, and peaked again slightly before and after the introduction of DMO 5 in July 2023. When making the initial 'glidepath' determination in the 2022/23 DMO determination the regulator stated that, to that point in time, competition had been reasonably strong in South Australia despite the historically low profit margins available to retailers. We would argue this continues to be the case, with a total of 28 retailers currently offering to residential customers in South Australia.

With regard to smaller retailers' competitiveness, it is worth noting the retailer with the current best residential market offer in South Australia has only 0.2 per cent of market share. Further, all six of this retailers' market offers include a substantial discount from the DMO, suggesting it is possible for small retailers to compete below the DMO in the current market. It is also noted that the two major retailers listed on the Australian Securities Exchange have had substantial profit announcements over the past 12 months, and associated share price rises. While it is noted these company announcements cover business activities broader than retail energy markets, and may not be consistent across all market participants, they are startling at a time consumers are doing it tough. It could therefore be argued that retailers are able to compete and earn a reasonable profit in the current market and DMO 6 should focus on protection of customers rather than retailers' profit margins.

While all DMO objectives are important, providing continued high retailer allowances to allow for competition should be reconsidered by the regulator. The Division considers that, at this point in time, protecting consumers from unreasonably high prices should be the central objective that the regulator considers.

The Division has consistently argued against the regulator's method to determine retailer allowances and therefore support the regulator's decision to reconsider its approach.

Basing the retailer allowance on a percentage basis meant that larger allowances would be included in the DMO if other cost components increase. This would effectively allow retailers to recover greater costs via standing offer customers for no justifiable reason, if other non-retail related costs increased - further intensifying price increases to consumers at difficult times. The regulator's DMO 5 decision to pause scheduled increases in the retail allowance at a time of high-cost increases confirms the concerns with the methodology when significant wholesale or network costs exist, and it should be reconsidered.

The Division has also argued against the glidepath approach adopted in DMO 4, which would have effectively seen retailer allowances for South Australian retailers increase from around 1 per cent in DMO 3 to a proposed 10 per cent in DMO 6. The Division considers a further increase to a 10 per cent retail allowance is a significant increase for residential customers in South Australia without sufficient justification, noting that this would add $228 for this cost component alone based on the current DMO amount (a $91 increase). The Division does not consider this approach is appropriate given current market conditions.

Further, the impact of a 15 per cent retailer allowance on small businesses should be reconsidered. As the Division has previously noted, despite the negligible change in percentage terms for the retailer allowance component for South Australian small businesses in DMO 5, the dollar figure increase was around $196 and a significant increase from the previous year (28.9 per cent) when compared to other jurisdictions. This is a considerable impact on small businesses in South Australia, with around 16.7 per cent of small businesses on standing contracts (versus 7.8 per cent for residential customers). While the Division notes the regulator's view that higher retail allowances for small business customers are justified as it reflects the different market characteristics and different risks for small business customers (such as higher level of average customer debt), the Division questions whether risks associated with bad and doubtful debt should not already be captured in the retail cost component, and therefore should not be factored into the retailer allowance.

Initially, when the regulator adopted this approach, it was suggested that a consistent retail allowance across the DMO regions would be desirable because the DMO objectives are the same for each region. However, it could also be argued that each DMO region is different, as evidenced by other cost components, customer transfer rates etc. and therefore different retail allowances in each jurisdiction could be justified.

With regard to metering costs, we anticipate that the regulator will obtain the required information from retailers to prevent any over-recovery of advanced meter costs, via one-off fees plus a DMO allowance. We also agree with the regulator's position to determine advanced meter costs based on historical costs incurred, rather than projecting costs based on expected installations during the DMO period. As there will be a number of reasons why a retailer will not reach the expected installation rates, or exceed them, it would be prudent to only base costs on those already incurred.

It is important that as advanced metering costs increase in the retail component of the DMO, the costs associated with accumulation meters captured in the network component are reducing. It is also critical that any benefits of a broader advanced meter rollout are captured in the DMO price, otherwise the justification for an accelerated advanced meter rollout is weakened. Benefits such as reduced meter reading and remote re/de-energisation costs should be considered, whether this is via retail cost component or the network cost component through the regulator's network determinations. As the AEMC has noted, the objective of the rollout is to enable a more efficient and lower-cost energy system that maximises the benefits for all consumers. It is therefore important that these benefits are captured and result in cost benefits to consumers, not just higher costs via the DMO.

Bringing forward the installation of advanced meters will also achieve economies of scale and process efficiencies compared to the current new and replacement approach, increasing net benefits to consumers.

The Division notes the concerns of the regulator regarding the liquidity in the South Australian market. The risk that ASX data does not reflect the hedging strategies of a prudent retailer should be tested, again, with a comparison with over the counter (OTC) contract information.

As we have previously noted, given the liquidity issues in South Australia, the proposal to include alternative sources of contract information into the regulator's book build process is supported to more accurately reflect costs that retailers face in South Australia. As different retailers choose to manage risk through a number of different instruments, including power purchase agreements, physical ownership of generation, options or other types of derivatives, an approach which better reflects the real-world hedging behaviour of retailers, extending beyond ASX products, should be considered.

We expect that relevant stakeholders active in the South Australian market will assist the regulator in considering what other strategies are more reflective of how retailers hedge their position in the state that should be considered.

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While the Division is aware of the reasons behind exploring amendments to the load profile we are wary of too many methodology changes occurring at one time, which may erode any easing of the wholesale cost component. Noting the significant recent increases in the DMO arising from wholesale cost increases, customers should not be burdened again due to methodological tinkering.

Finally, the Division notes that in DMO 5 the regulator added one day's consumption to the annual usage due to a leap year in 2023/24. This resulted in an increase from 4,000 kWh to 4,011 kWh for South Australian residential customers without controlled load, and similar increases for the other customer types. The DMO 5 determination noted that in the future the regulator will reflect annual consumption relative to number of days in the determination year. We therefore expect the DMO 6 determination to revert to a 4,000 kWh for residential customers without controlled load (and other associated changes) given there are 365 days in 2024/25. This would provide consistency with the majority of DMO determinations.

The Division continues to support other aspects of the regulator's methodology which are proposed to remain unchanged.

The Division thanks the regulator for the work on this important determination. Should you have any questions in relation to this submission, please contact Mr Chris Leverington, Senior Policy Officer, Energy and Technical Regulation Division, on (08) 8429 3298.

Yours sincerely

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DEPUTY CHIEF EXECUTIVE
DEPARTMENT FOR ENERGY AND MINING

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