AGL Energy Limited
T 02 9921 2999
agl.com.au
ABN: 74 115 061 375

Level 24, 200 George St
Sydney NSW 2000
Locked Bag 14120 MCMC
Melbourne VIC 8001

Daniel Harding

General Manager (A/g), Market Performance

Australian Energy Regulator

GPO Box 3131

Canberra ACT 2601t

Via email: DMO@aer.gov.au

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2024-25 Default Market Offer Draft Determination

AGL welcomes this opportunity to provide comment on the Australian Energy Regulator's (AER) consultation on the 2024-25 Default Market Offer (DMO) draft determination (Draft Determination).

AGL operates nationally across the energy supply chain and delivers 4.3 million gas, electricity, and telecommunications services to our residential, small and large business, and wholesale customers across Australia. We also operate Australia's largest electricity generation portfolio, with a generation capacity of over 11,000 MW, accounting for approximately 20% of the total generation in the National Electricity Market.

The AER's Draft Determination sets out the proposed retail electricity DMO prices that will apply from 1 July 2024. Subject to proposed changes to the methodology to calculate the wholesale energy costs (WEC) and the significant adjustment of the retail allowance components of the DMO price, the other cost components of the pricing methodology remain largely the same as previous DMO pricing determinations.

The Draft Determination demonstrates a shift in the underlying cost pressures on customer bills from wholesale to network costs. Network costs are the largest component of retail bills. We note the regulatory and economic drivers that are causing the forecast increase in network prices are likely to remain in place beyond this DMO pricing period. Whilst the proposed one-off reductions in the retail component of the DMO price have in part offset the increases in the network costs, there are now significant affordability challenges for future DMO pricing determinations if the network charges continue to grow.

Set out in the attachment below is our response to the Draft Determination. Our response raises two key issues; the NSLP approach for Energex and SAPN and the implications of removing the competition allowance.

If you have any questions in relation to this submission, please contact Kyle Auret on kauret@agl.com.au.

Yours sincerely,

Ralph Griffiths
General Manager
Policy and Market Regulation

Attachment: AGL response to 2024-25 DMO Draft Determination

Wholesale Energy Costs

The Draft Determination proposes two changes to the WEC component of the DMO, the adjustment of the NSLP in Energex and SAPN, and the blending of interval meter data with the NSLP for each region. Our response to these changes is outlined below.

Energex and SAPN NSLP adjustments

We do not consider the AER's proposed NSLP adjustment for the Energex and SAPN NSLP appropriately reflects the forecast representative customer load for accumulation meters in these regions.

In the Draft Determination, the AER decided to adopt the midpoint of the WEC estimates based on AEMO's non-adjusted NSLP and ACIL Allen's adjusted NSLP. Whilst we acknowledge the AER's views that the inclusion of the non-adjusted NSLP provides transparency and continuity of the methodology, we do not consider these factors supersede the overall regulatory objective of determining a customer load profile that is broadly representative of a retailer's forecast customer load in each region.

As set out in our previous submission, a key objective of the DMO methodology is to determine a reasonable representation of a retailer's customer load profile for the forecast period. In our view, ACIL Allen's adjusted NSLP is the best possible reflection of a forecast accumulation meter customer load profile. As recommended by ACIL Allen, the adjustment is a preferred profile as it corrects a known interim measure that altered the shape of the historical NSLP in the FY23 and FY22 data sets. Importantly, AEMO's interim measure will not apply during the DMO 6 pricing period.

A prudent retailer will not include profile assumptions in the forecast pricing period that are known not to occur in that period, in this case the interim measure. Therefore, reasonable steps should be taken to remove the interim measure from any forecast profile. In this case, the ACIL Allen adjustment provides an appropriate solution to address this. The AER should therefore only apply the adjusted NSLP WEC calculation for Energex and SAPN regions rather than the proposed midpoint.

We acknowledge that the meter data and NSLP issues assessed through the DMO review process are complex. We also note that the impact of the anomalies is growing exponentially with the accelerated roll out of smart meters and ongoing rapid uptake of solar. We encourage the AER to establish a technical working group on meter data and load profiles to resolve methodological issues well ahead of commencing the process for establishing the 2025-26 DMO.

Blending of NSLP and Interval Meter Data

We support the AER's decision to include interval meter customers data along with accumulation meter data (NSLP) when forecasting the representative retailer's load. As we have stated in previous DMO pricing determinations, we consider a profile using all of these meter types is a more accurate reflection of a representative retailers load shape.

Retail Allowance Component

The Draft Determination proposes to split the retail allowance component of the DMO into two separate components, a retail margin and competition allowance. Whilst these two components have implicitly been identifiable in previous DMO pricing determinations, the express separation is proposed to enable the AER to assess each component separately.

Retail Margin

The Draft Determination proposes to lower the retail margin to a uniform percentage for all regions of 6% for residential customers and 11% for small business customers.

We support the AER's decision to apply a percentage benchmark rather than an absolute dollar amount. As the AER observes in the draft determination, other regulatory pricing methodologies have consistently applied a percentage amount when calculating the retail margin. This approach reflects the need to adjust the component when customer costs of supply change and in turn the commensurate commercial risks that retailers' face changes as well.

We accept the AER's proposed retail margin benchmarks, however as noted below these benchmarks can only be realised if the other cost components of the DMO price are certain to be accurate.

Whilst the DMO price aims to reflect a retailer's prudent and efficient annual costs of supplying a representative customer, given the various types of retailers in the market and the broad customer types and usage patterns, it is impossible for a single DMO price for residential customers and one for small business customers to appropriately reflect the costs of supply under each of these potential arrangements (noting the additional DMO prices for residential controlled load).

There are also significant uncertainties in all cost parameters, in addition to the well acknowledged issues in relation to meter data and estimating representative load profiles. The compounding effect of setting a thin retail margin allowance and no competition allowance increases the risk that in aggregate the DMO may substantially underestimate the actual reasonable costs, increasing risk of further retail failures in addition to crimping competition and innovation.

As noted in the draft determination, the recent ACCC report on retail margins demonstrates there may be significantly tighter retailer margins than envisioned by the AER when determining the DMO price. These studies demonstrate that that the actual retail margins across the market are extremely thin and that DMO calculation may provide false comfort as to whether the DMO is set at a sufficient level to allow retailers to compete below it.

Competition Allowance

The draft determination proposes to not include a competition allowance for the regulatory pricing period. The AER states that the DMO price needs to reflect a greater weighting to the DMO price protection objectives given the current cost of living pressures and affordability of electricity.

We support the AER's role of applying regulatory measures that ensure customers pay no more than is necessary for an essential service. As the AER and other key industry and government stakeholders have highlighted, the best way to achieve this is for a customer to get the best possible market offer for them.

The role of the DMO price is a safety net. It is not the primary driver to ensure customers attain a price that will result in the least cost to them. The best regulatory measures to address affordability, and minimise costs to consumers, is to address the regulatory and industry barriers that may prevent customers from attaining the best available market offer.

The DMO was created to give effect to recommendations of the ACCC in the 2019 Retail Electricity Price Inquiry (**REPI**) report. The ACCC's submission to the AER position paper highlighted the importance of the DMO price being set sufficiently above 'efficient' market offers to allow scope for retailers to continue to compete, and for the benefits of retail competition to be retained. The ACCC noted they do not want the DMO to become a viable alternative for engaged consumers that can find good deals. Engaged consumers drive efficiency and innovation in the electricity sector by responding to new offerings from retailers. Losing this engagement would result in less effective retail competition and is unlikely to be in the long-term interest of consumers.

Regulatory certainty

As set out in the draft determination, the AER will determine when it is appropriate to re-introduce the competition component in the DMO. As an inferred example in the paper, this may include when CPI is sustained within the RBA target band. Other than this broad guidance, there is no firm metric or circumstances that would clearly trigger the component to be re-introduced. Without a clear methodology as to when the component is included, there is regulatory uncertainty. A key regulatory principle of the DMO price is that the methodology is predictable and readily understood by the industry. This is an important feature of the regulatory framework as this provides industry certainty on a material factor in the market. The AER must define the metric or circumstances that will trigger the component's inclusion in the DMO price. If this cannot be done, then this approach materially undermines the DMO policy objective of maintaining incentives for competition and customer engagement.