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To Daniel Harding,

Default Market Offer prices 2024-25 – Draft determination

ENGIE Australia & New Zealand (ENGIE) appreciates the opportunity to respond to the Australian Energy Regulator (AER) in response to the draft determination on the Default Market Offer (DMO 6) prices for 2024-25.

The ENGIE Group is a global energy operator in the businesses of electricity, natural gas and energy services. In Australia, ENGIE operates an asset fleet which includes renewables, gas-powered generation, diesel peakers, and battery energy storage systems. ENGIE also owns Simply Energy which provides electricity and gas to retail customers across Victoria, South Australia, New South Wales, Queensland, and Western Australia.

ENGIE is concerned that the AER's approach to setting DMO 6 does not appear to adequately balance the DMO policy objectives and will likely result in a DMO price that is a low-priced alternative to a market offer instead of the intended backstop price that protects consumers from unreasonably high prices. In this submission, ENGIE provides feedback on the AER's wholesale cost and retail cost methodologies. ENGIE also urges the AER to reinstate the competition allowance in its final determination and set this on a percentage basis.

Wholesale energy costs

The NSLP approach should provide a greater weighting on the ACIL Allen adjustment

ENGIE does not agree with the AER that the two options presented in the February 2024 consultation paper are evenly balanced in their merits and disadvantages. As was evidenced in the February 2024 consultation paper, the load profile shape from October 2021 to June 2023 (when AEMO's temporary adjustment to the Net System Load Profile data was in effect) was significantly different to the load profile shape that existed before and after this period. It is clear that the AEMO adjusted load profile will not realistically reflect the load profile shape that will eventuate in 2024-25 and placing a significant weight on this data would result in retailers under-recovering their wholesale energy costs for their accumulation meter load.

In our view, the ACIL Allen manual adjustment of the NSLP data is more likely to reflect the forecast accumulation meter load profile for 2024-25. We note that ACIL Allen will have access to more data by the time of the AER's final determination, which should further improve the accuracy of this manual adjustment.

Despite the significant issues with the AEMO adjusted NSLP data, we accept that the AER is mindful of the risk of over-estimating the wholesale cost component of the DMO. In that case, instead of solely relying on the ACIL Allen adjusted load profile, we consider it would be reasonable to adjust the weightings between the two approaches to provide a greater weighting to the ACIL Allen adjusted load profile. For example, a 75/25 weighting would result in a load profile that is more reflective of the load profile shape that could be expected to eventuate in 2024-25 when compared to the approach taken in the draft determination.

The use of OTC data in the South Australian methodology is appropriate

ENGIE supports the AER's continued use of over-the-counter (OTC) contract market data for South Australia to supplement information about contracts traded on the ASX. As noted in our submission to the issues paper, this methodology will provide an understanding of the contracts used to hedge retail load in South Australia, as baseload swaps and caps are not a very effective hedge in this region.

The 95th percentile estimate is the most appropriate margin for forecast error

ENGIE continues to advocate for the AER to return the margin for forecast error back to the 95th percentile estimate. The AER's current methodology to take the 75th percentile estimate does not take sufficient account of retailers' exposure to high prices and does not reflect a prudent approach to hedging risk in the current wholesale electricity market, where the energy generation fleet is transitioning to renewable energy sources and the risk of international-driven volatility remain.

ENGIE does not consider that the use of the 75th percentile estimate aligns with the DMO policy objective to allow retailers to recover their efficient costs of providing services.

Retail costs

While ENGIE did not initially support the AER's move to a bottom-up cost stack methodology for the estimation of retail costs, we do support the AER maintaining the use of this methodology for the purpose of regulatory certainty until the AER undertakes a broader review of the DMO methodology.

We have previously noted that the Australian Competition and Consumer Commission's (ACCC) Electricity Inquiry data will be unlikely to be fully representative of most retailers and may not incorporate all relevant costs. However, we accepted that the risk arising from these inaccuracies would be reduced if the retail allowance was set sufficiently high to account for this risk. As will be discussed in more detail later in this submission, we are concerned that the removal of the competition allowance in DMO 6 will expose retailers to significant risk if forecasting deficiencies do eventuate.

The AER's approach to bad and doubtful debt is reasonable

ENGIE supports the AER's approach to using the ACCC Electricity Inquiry data as the basis for determining bad and doubtful debt costs. We also support the AER's proposal to consider bad and doubtful debts on a state-by-state basis for DMO 6 and agree that this provides a more representative estimate.

The use of actual smart meter costs is reasonable, but forecast installations should be included

ENGIE supports the AER using information on the actual costs reported by retailers when determining the smart meter cost component of DMO 6. However, we note that historical installation data will not be fully reflective of the actual installations in 2024-25, as the trend of increasing installations will likely continue. It was not clear from the draft determination how the AER calculated the estimated cost of capital to cover this shortfall, but the estimated amount does appear to be quite low when compared to the average annual cost per smart meter.

Retail margin

ENGIE has consistently advocated for the AER to adopt a more objective and transparent methodology for estimating the previous 'retail allowance' component of the DMO and to individually estimate its cost items (that is, the retail margin, competition allowance, and an uplift to cover forecast errors that are not included elsewhere in the cost stack). We were pleased to see that the AER has taken on board this feedback in its draft determination for DMO 6.

ENGIE supports the retail margin being set as a percentage of the DMO price and is comfortable with the AER's estimated efficient margin for residential and small business customers. ENGIE urges the AER to commit to maintaining the percentage level of the retail margin for a period of time (for example, three years) to maintain regulatory certainty for all stakeholders. We also do not expect that the inputs into the retail margin would move significantly from year-to-year, which supports maintaining some stability of this cost component.

Retail competition allowance

The DMO was introduced to be a 'backstop' with a generous level of headroom above the reasonable cost of supplying customers, which would give space for a healthy competitive market to be the normal mode of supplying customers. The DMO therefore provides fallback protection from excessively high prices for those consumers who are not engaged in the market. Unlike the Victorian Default Offer, the DMO is not intended to be a relatively low-priced alternative to a market offer.

When recommending the introduction of a DMO, the ACCC stated that it should effectively be a premium offer with additional safeguard features that come at a cost. The ACCC stated that the DMO should not be the lowest price, or close to the lowest price, in the market and that it must be set above the price of competitive market offers to avoid incentivising consumer disengagement.[1]

As the AER has noted, it is required to balance the following policy objectives when setting the DMO price:

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

The AER has stated that for DMO 6 it intends to place greater weight on the policy objective to protect consumers from unreasonable prices. We do not agree that the inclusion of the competition allowance would result in 'unreasonable prices' for consumers. As described above, the competition allowance is a critical component of the DMO price that has existed since the DMO was introduced. Without the competition allowance, the DMO price is unlikely to be set at a level that is above competitive market offers and incentivises consumers to engage in the retail energy market.

ENGIE is concerned that by excluding the competition allowance, the AER has not adequately balanced its policy objectives and has not proposed a DMO price that aligns with the intent of this reform. ENGIE urges the AER to reinstate the competition allowance in its final determination and set this on a percentage basis.

In the sections below, ENGIE provides further detail on factors the AER should consider when deciding whether to exclude the competition allowance from its DMO 6 final determination.

Other tools are more appropriate to target electricity affordability concerns

ENGIE agrees that electricity affordability is a significant issue, and we are actively helping our customers manage their energy costs and bills through this challenging period.[2] However, we do not agree that excluding the competition allowance from the DMO is an effective or appropriate tool to address cost of living pressures. As most customers are not on standing offer contracts, the removal of the competition allowance methodology will not directly lower the retail electricity prices that the majority of customers are paying.

ENGIE considers that government policy will be a more appropriate tool to provide customers with relief from retail electricity bills than making temporary adjustments to the DMO methodology. Governments have many tools that can provide direct benefits to consumers if they are concerned about addressing cost

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[1] Australian Competition and Consumer Commission 2018, Retail Electricity Pricing Inquiry – Final Report, June, p. 249 and 250.

[2] For example, Simply Energy ran a program called 'Here to Help' in 2023 that provided hardship customers with payment matching and energy reduction incentives.

of living pressures (for example, governments could adjust concessions and rebates, expand and/or extend the Energy Bill Relief program, and make adjustments to taxation policy as is occurring in July 2024).

More broadly, we note that the competition allowance is a relatively small percentage of the DMO price and that its removal would not provide a significant alleviation in electricity affordability for customers on standing offers.

It will be challenging to justify the return of the competition allowance once it is excluded

ENGIE is concerned that if the AER excludes the competition allowance from DMO 6 that it will be very challenging for the AER to reinstate it in future DMO price decisions, as this will necessarily result in a higher DMO price than would otherwise occur. In the event that the competition allowance were to be reinstated, the ability of the AER's methodology to exclude the competition allowance from the DMO price at any time creates uncertainty for industry that it could again be excluded in a future year.

The AER has justified the exclusion of the competition allowance largely due to the current economic conditions, however we note there will almost always be issues in the economy and customers that struggle to afford energy bills. Despite the current inflation levels, the Australian unemployment rate remains at very low levels (currently at 3.8 per cent[3]) and the Reserve Bank of Australia is optimistic about the Australian economy and the strength of the labour market, as well as the capacity of households to service their debt and meet essential expenses.[4]

Retailers have well established processes for supporting customers that have payment difficulties, and we consider that these processes should be utilised to provide customers with tailored support to manage their energy bills during this period of cost of living pressures.

Excluding the competition allowance is counter to government policies to promote CER innovation

The AER noted that by excluding the competition allowance it has placed greater weight on the policy objective to protect consumers from unreasonable prices, relative to the other policy objectives. In our view, the AER's proposal to exclude the competition allowance would not align with the policy objective to maintain incentives for competition, innovation and consumer engagement in the market.

ENGIE considers that removing incentives for competition and innovation would run counter to government policies that are actively considering incentives and opportunities related to consumer energy resources (CER) and other tools to promote energy efficiency and electrification. For example:

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[3] Australian Bureau of Statistics 2024, Labour Force Australia – February 2024, accessed at: https://www.abs.gov.au/statistics/labour/employment-and-unemployment/labour-force-australia/latest-release

[4] Reserve Bank of Australia 2024, Financial Stability Review March 2024 – Financial Stability Assessment, accessed at; https://www.rba.gov.au/publications/fsr/2024/mar/financial-stability-assessment.html

- Ministers at the Energy and Climate Change Ministerial Council have committed to the development of a National CER Roadmap to unlock consumer benefits for locally generated and stored power and deliver new consumer protections and reforms that enable the development of new technologies.[5]

- The New South Wales Government is developing a Consumer Energy Strategy, which will aim to help support NSW households through the energy transition and will consider the current incentives and opportunities related to CER assets, energy efficiency, electrification and consumer protections.[6]

- The South Australian Government is supporting the development of active management capabilities for CER assets, through its support of Virtual Power Plants (VPP)[7] and policies in relation to electric vehicles and associated smart chargers and participation in VPPs[8].

The competition allowance should be set as a percentage of the DMO price and consider forecasting risks

ENGIE does not support the competition allowance being set on a dollar per customer basis instead of on a percentage basis. As has been discussed in the sections above, the DMO price should be set sufficiently higher than competitive market offers to ensure consumers are not disengaged and that retailers are incentivised to compete and invest in innovation. By setting the competition allowance on a percentage basis, it ensures that the competition allowance continues to provide for a DMO price that is at a relatively consistent level above competitive market offers. There is a risk that a competition allowance set on a dollar per customer basis does not increase/decrease in line with other cost components of the DMO and results in a DMO price that is either too close or too far from competitive market offer prices.

ENGIE previously advocated for the AER to adopt a more objective and transparent methodology for the previous retail allowance, which would include individually estimating its cost items. As part of our previous feedback, we suggested that the retail allowance should include an uplift to cover the risk of forecast errors that are not included elsewhere in the cost stack. For example, we identified risks that the ACCC cost data would underestimate actual retail costs and risks introduced through the AER's adoption of the 75th percentile for wholesale costs. By not explicitly considering forecasting risks and setting a conservatively estimated DMO price, we question whether the draft DMO 6 will have sufficient buffer to ensure retailers can still recover their efficient costs in the event that forecasting risks eventuate.

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[5] Energy and Climate Change Ministerial Council Meeting, 24 November 2023 and 1 March 2024, accessed at; https://www.energy.gov.au/energy-and-climate-change-ministerial-council/meetings-and-communiques

[6] NSW Climate and Energy Action, NSW Consumer Energy Strategy, accessed at; https://www.energy.nsw.gov.au/nsw-plans-and-progress/regulation-and-policy/nsw-consumer-energy-strategy

[7] Department of Energy and Mining, South Australia's Virtual Power Plan, accessed at; https://www.energymining.sa.gov.au/consumers/solar-and-batteries/south-australias-virtual-power-plant

[8] Government of South Australia 2020, South Australia's Electric Vehicle Action Plan, December, accessed at; https://www.energymining.sa.gov.au/__data/assets/pdf_file/0009/609390/DEM-Electric-Vehicle-Action-Plan.pdf

Concluding remarks

ENGIE looks forward to working actively with the AER to ensure that the DMO 6 price accurately reflects forecast changes in the cost of supplying electricity retail customers and meets the DMO policy objectives.

Should you have any queries in relation to this submission please do not hesitate to contact me on, telephone, 0436 929 403.

Yours sincerely,

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