AUSTRALIAN ENERGY COUNCIL

Natalie Elkins
General Manager, Market Performance
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

14 November 2024

Dear Ms Elkins,

Default market offer prices 2025-26 issues paper

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission on the Australian Energy Regulator's ('AER') *Default market offer ('DMO') prices 2025-26 issues paper.*

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 percent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

When setting the DMO price, the AER attempts to find the balance between protecting customers from unreasonably high prices, supporting reasonable and efficient margins, and supporting competition. The AEC fully understands the pressures on consumer bills in terms of rising costs related to wholesale and network price increases. However, we are also concerned about a potential situation where retail is squeezed to accommodate price rises in other parts of the chain.

The AEC notes that currently, retailer margins are at all-time lows and the competition allowance has been removed with uncertainty about when it will be reintroduced. The AEC has a heightened awareness of the extremely challenging operating environment for smaller retailers and urges the AER to allow for strong consideration of their needs during the price-setting process.

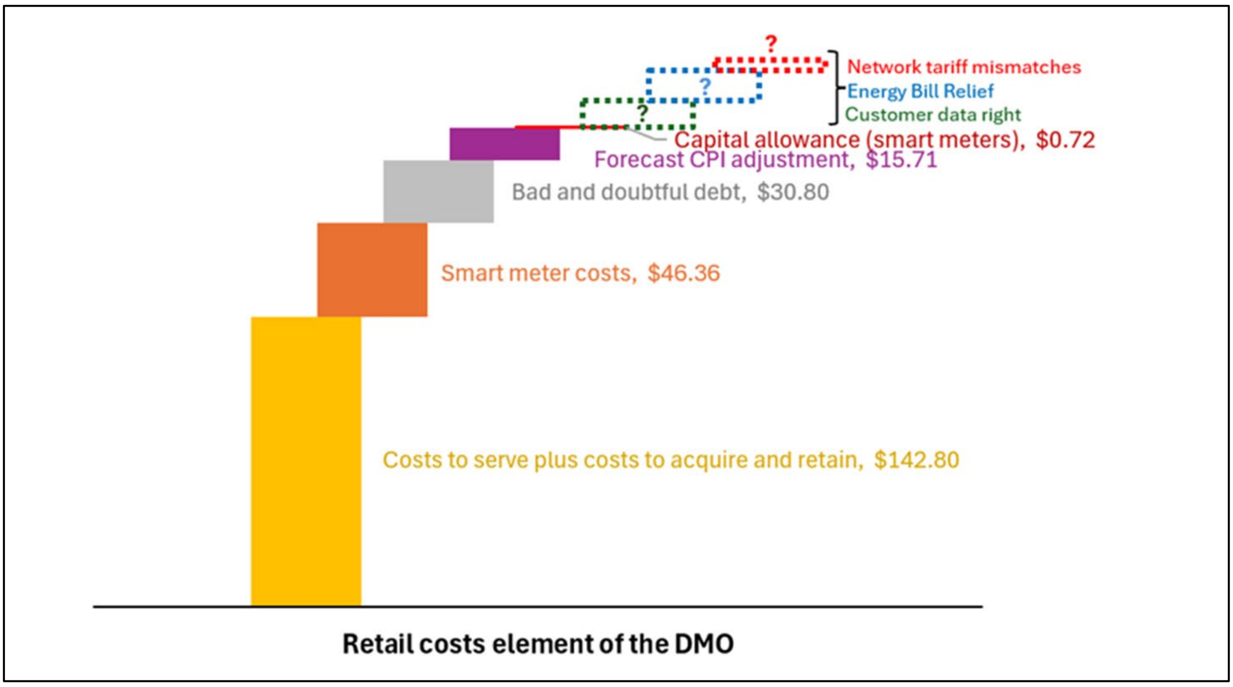
For example, it is not clear how the AER will consider the potential mismatch between network and retail tariff structures if the AEMC's proposed recommendation from its Accelerating smart meter rule change are progressed. The AEC's medium and smaller members report that this is a particularly challenging issue for them, and they find it extremely challenging to accommodate a mismatch. The AEC supports the AER's investigation into the mismatch between some network and retail tariffs.

Our members feel that the overall risks of being a retailer in the NEM have persisted for multiple years. This is putting pressure on retailers to compete on price and innovate.

We are concerned that there is a great risk of the DMO reducing retailer margins beyond retailer viability. We are also concerned that failure to reinstate the competition allowance will impact the ability of retailers to innovate. Additional pressures on retailer innovation are illustrated in the diagram below of retailer costs. The fully shaded items represent those costs provided for in the DMO. The dotted lines represent additional costs that retailers are expected to wear, without any DMO allocation.

This diagram shows that the risks and costs of being a retailer in the NEM have not diminished since the last DMO decision, yet the retailer allowance has reduced from 10 per cent to 6 per cent and the competition allowance has been removed. While the primary purpose of the competition allowance was to support innovation and competition it also provided a buffer so that retailers could absorb some additional costs by timing differences in the recovery of costs, as well as differences between forecast and actual costs.

Diagram 1: Unrecovered retail costs



The AEC recognises the importance of innovation in enabling the energy transition. Given the importance of innovation to maximising customer opportunities, the AEC encourages the AER to be cognisant of the role the DMO can play in supporting innovation.

For this reason, we consider that the AER should set out a clear and objective process for reintroducing the competition allowance.

In terms of wholesale costs, the AEC considers that the AER should test the accuracy of its wholesale cost model by comparing model outcomes with actual spot price outcomes over time. This will provide an objective assessment and guide future decisions about risk; notably in deciding whether to revert back to the 95th percentile of modelled outcomes.

It appears that over the 6 years the DMO has been in place, reasons have been provided by the AER for changes in the methodology. The AEC considers that there is merit in considering whether the AER should develop a refreshed set of principles that it could apply consistently to DMO setting. These principles could be designed around the original principles of the DMO and also new ones could be developed. For example, the AER could develop a principle around incorporating new and emerging processes occurring in the energy market. The increasing penetration of interval meters is one such process, as is the mismatch between some network and retail tariffs. The AEC believes refreshed principles like these would result in better outcomes for all stakeholders, provide assistance to the AER in balancing the DMO elements and allow for greater transparency in price-setting.

Any questions about this submission should be addressed to Jo De Silva, General Manager Retail Policy by email to jo.desilva@energycouncil.com.au or by telephone on 03 9205 3100.

Yours sincerely,

Jo De Silva

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