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

8 November 2024

To Natalie Elkins,

Default Market Offer prices 2025-26 – Issues paper

ENGIE Australia & New Zealand (ENGIE) appreciates the opportunity to respond to the Australian Energy Regulator (AER) regarding the issues paper on the Default Market Offer (DMO 7) for 2025-26.

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 that includes renewables, gas-powered generation, diesel peakers, and battery energy storage systems. ENGIE also provides electricity and gas to retail customers across Victoria, South Australia, New South Wales, Queensland, and Western Australia.

ENGIE is committed to delivering affordable and reliable energy solutions to our customers. ENGIE fully acknowledges the cost-of-living pressures currently experienced by households and is actively supporting our customers that experience financial hardship and payment difficulties.

In this submission, ENGIE provides general commentary on the state of the DMO, as well as feedback on the AER's proposed wholesale and retail cost methodologies, and the methodology to include or exclude the competition allowance from the cost stack.

The state of the DMO

The DMO is transitioning away from acting as a backstop, while frequent adjustments to the methodology create uncertainty for retailers

The DMO was introduced in 2019 as a backstop to protect consumers from excessive energy prices and prevent retailers from passing on unjustified costs. At the inception of the DMO, the Department of Climate

Change, Energy, the Environment and Water (DCCEEW) stated that the purpose of the DMO was to 'stop excessively priced standing offers.'[1] The DMO was, and is not, intended to be the best offer in the market.

The DMO's purpose differs from that of the Victorian Default Offer, which is a regulated price for electricity standing offers that was also introduced in 2019. The purpose of the Victorian Default Offer is to be a *reasonable* price to provide a safeguard for customers on standing offers.[2] Conversely, the DMO is intended to function as a *safety net.*[3]

ENGIE recognises the challenging environment in which the AER must balance the competing policy objectives of the DMO including:

- Protecting customers from unreasonable retail electricity prices,
- Allowing retailers to recover their efficient costs and earn a reasonable retail margin; and
- Maintaining incentives for competition and innovation.

ENGIE remains concerned that the AER's approach to setting the DMO inadequately balances the policy objectives. ENGIE contends that the AER has been placing too little weight on the objective to allow retailers to recover efficient costs and earn a reasonable retail margin. This will likely lead to long-term negative customer outcomes if overall competitiveness in the retail market declines.

Additionally, frequent adjustments to the DMO methodology have introduced instability for retailers. The AER's bottom-up approach to calculating the DMO has introduced a degree of "false precision", where attempts to fine-tune the DMO create complexity and uncertainty for retailers. This, coupled with the recent exclusion of a competition allowance and the requirement for retailers to absorb cost reductions, compounds the pressure for retailers in operating sustainable retail businesses and delivering both cost-effective and innovative products to consumers.

The feedback in the remainder of this submission is provided with the above context in mind, that the DMO should function as a safety net and be set in a way that balances the policy objectives.

[1] Department of Climate Change, Energy, the Environment and Water (DCCEEW), 2019. *Introduction of a Default Market Offer Reference Price.* Link.

[2] Essential Services Commission (ESC), 2023. *Victorian Default Offer 2024-25 Final Decision Paper*. Link.

[3] Department of Climate Change, Energy, the Environment and Water (DCCEEW), 2023. *A Price Safety Net Factsheet.* Link.

Wholesale costs

Of the two options presented, interval meter data blended with the NSLP is the most appropriate method to simulate a load profile

ENGIE supports Option 2, which simulates the load profile by blending one year of NSLP data with interval meter data. As most retailers have a customer base with both accumulation meters and interval meters, this option would more closely reflect retailers' actual hedging practices.

ENGIE notes that interval meter data has been provided to the AER confidentially and is currently unavailable for public release. ENGIE prefers accuracy being prioritised over transparency, as long as the methodology is clear. ENGIE requests that the AER work toward resolving the confidentiality constraints that prevent retailers from accessing this data and consider options to publish aggregated information on the blended load profiles.

Efforts should be made to separate load profiles and associated wholesale cost forecasts for residential and small business customers

ENGIE supports creating separate profiles to allow for more accurate forecasting of wholesale costs, reflecting the differences in energy usage behaviour between residential and small business customers. A prudent retailer will consider the difference in load profiles for residential and small business customers, as the different load profiles influence peak demand periods, load variability and sensitivity to price changes.[4] While acknowledging issues with the available load profile data, ENGIE considers this separation is the next crucial step in creating more accurate load profiles and wholesale cost forecasts for residential and small business customers.

The NSW-controlled load profile remains relevant to retailers' hedging strategies

ENGIE supports Option 2, which blends historical controlled load data with the NSLP as it reflects the basis for settlement and aligns more closely with a prudent retailer's hedging strategy of considering an amalgamation of historical datasets relevant to their customer base. While this approach has challenges, such as estimating controlled load volume accurately, it provides a profile that realistically combines controlled load and the NSLP.

Accounting for any additional hedging costs arising from customers' solar exports is crucial as they impact a prudent retailer's hedging strategy

ENGIE supports the AER accounting for the additional hedging costs associated with solar exports. This is because the exclusion of solar exports from the load profiles does not reflect the hedging strategy of a

[4] Simply Energy, 2023. *Submission - DMO 6 Issues Paper*. Link.

prudent retailer that hedges for their net load. Excluding solar exports flattens the AER's load profiles and therefore underestimates the costs of the contracts that retailers need to purchase to hedge their net load.

ENGIE notes that feed-in tariffs are not an effective tool to manage the additional cost of hedging a peakier load, especially during times when solar exports drive net demand into negative spot prices.

Repeating the long-run marginal cost (LRMC) analysis for DMO 7 may be beneficial to validate wholesale energy costs in South Australia

ENGIE continues to support 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. Repeating the LRMC analysis for DMO 7 would offer a comparative data point for wholesale electricity costs in South Australia. Continuing this analysis may provide further insights into cost trends, particularly in light of the first tranche of OTC data and its influence on market liquidity assessments. This is especially relevant given that the previous LRMC analysis for DMO 6 produced comparable, though slightly lower, wholesale cost estimates.

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

ENGIE considers the 75th percentile estimate does not align with the DMO policy objective of allowing retailers to recover their efficient costs of providing services. We disagree with the assessment that the 75th percentile 'strikes the right balance between retailers recovering the efficient costs for providing their services and the allocation of risks to consumers.'[5] We continue to advocate for the AER to return the margin for forecast error to the 95th percentile estimate. This viewpoint has been addressed in detail across previous submissions.

The 75th percentile does not sufficiently account for retailers' exposure to high prices or reflect the prudent approach required in the current volatile wholesale electricity market. ENGIE also notes that the AER's methodology does not reflect other factors that retailers must account for when developing their hedging strategies, such as variabilities in customer numbers and load throughout the year and unexpected fluctuations in weather.

ENGIE would welcome the AER conducting backcast analysis of its previous wholesale cost forecasts against actual outcomes to determine whether the 75th percentile estimate provided an appropriate estimate of wholesale costs.

[5] Australian Energy Regulator (AER), 2024. *Default Market Offer Prices 2025–26 Issues Paper*. Link.

Retail costs

The extent to which the expanded retailer cost dataset will influence regulatory decision-making is unclear

ENGIE understands the need to collect new data given the Australian Competition and Consumer Commission's (ACCC) Inquiry into the National Electricity Market (NEM) is sunsetting on 31 August 2025. For that reason, ENGIE supports the AER's intent to develop its own dataset of costs to serve, costs to acquire and retain, and bad and doubtful debt costs. However, the extent to which the expanded retailer cost dataset will shape regulatory decision-making is uncertain. The ACCC dataset, used in previous DMO decisions, captured 84 per cent of customers and already highlighted significant differences in retail costs between large and small retailers on a per customer basis.

ENGIE does not support the AER using customer-weighted averages to calculate retailer costs, which was used in the ACCC's calculation methodology, as the cost is skewed towards retailers with much larger customer bases. This is because in aggregate, Tier 1 retailers continue to benefit from considerable cost advantages over smaller retailers, particularly in costs to serve and costs associated with acquiring and retaining customers.[6] As the DMO provides a price cap on electricity standing offers for all retailers, not just Tier 1 retailers, the use of a cost estimate that is primarily reflective of these larger retailers will likely make it more challenging for smaller retailers to recover their efficient costs and compete in the market.

ENGIE recommends that the AER conduct statistical testing on its new dataset to determine the most appropriate calculation method. Examples of the calculation methods the AER should consider testing include the median value and considering a percentile within the distribution of costs.

With respect to the AER's approach to bad and doubtful debt in DMO 7, ENGIE considers the approach is reasonable but awaits confirmation of final costs.

Forecast meter installations should be included in smart meter cost estimates

ENGIE contends that expanding the smart meter allowance to include actual and forecast installations would ensure that the full range of smart meter costs is considered. As highlighted in our DMO 6 submission, historical installation data alone is unlikely to capture the true quantum of installations, which will likely continue in line with the mandated smart meter rollout. ENGIE notes that the mandated smart meter rollout is due to commence within the DMO 7 period and retailers will incur unavoidable costs to meet their 2026 interim targets.

---

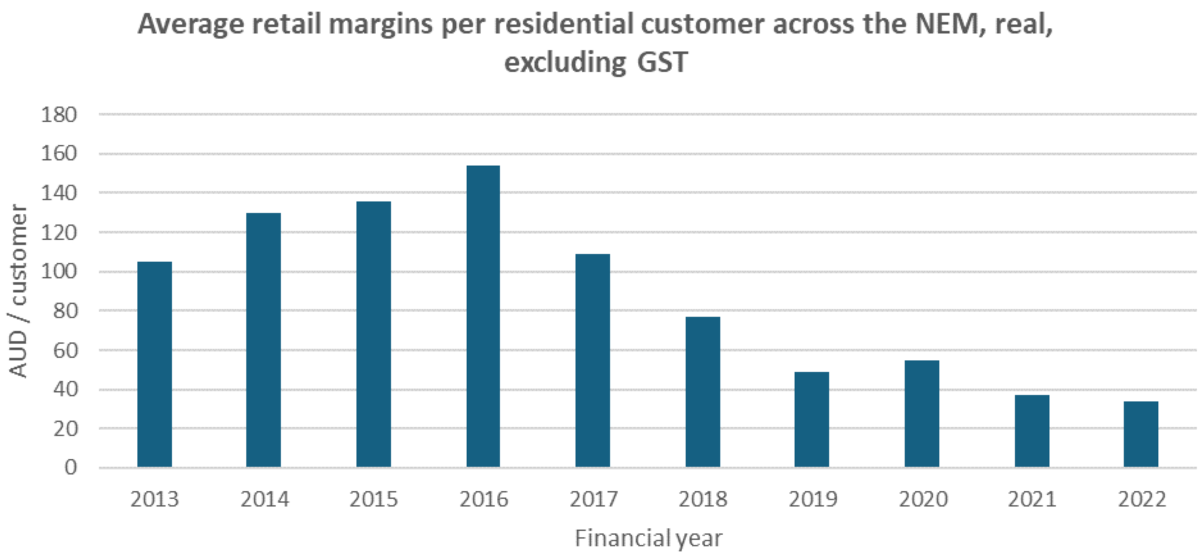
[6] Australian Competition and Consumer Commission (ACCC), 2023. *Inquiry into the National Electricity Market: December 2023 Report.* Link.

Retail margin and competition allowance

The average retail margin has decreased considerably since 2016, while electricity retailing risks continue to permeate

Retailers play a vital role in managing spot price risks on behalf of customers, with a reasonable margin providing an important buffer for retailers in managing this volatility. However, the ACCC has raised concerns that the risks associated with electricity retailing have increased in recent years.[7] The figure below, adapted from the ACCC's Electricity Inquiry data, shows that the average retail margin across the NEM declined by $3 per residential customer (an 8 per cent reduction) in real terms in 2022–23.[8] This aligns with a broader trend of decreasing retail margins, which fell from a peak of $154 per residential customer in 2016–17 to a low of $34 per customer in 2022–23 (in real terms).[9] The ACCC notes that retail margins dropped significantly from FY 19, coinciding with the implementation of the DMO and Victorian Default Offer.[10]

Figure 1 Average retail margins per residential customer across the NEM, real, excluding GST



Small energy retailers are exiting the market amidst high operational costs in the current economic environment

Small energy retailers are already feeling the impacts of high operational costs of the current economic environment and historically low retail margins. FY 23 saw smaller retailers decrease customer numbers for

---

[7] Ibid.

[8] Ibid.

[9] Ibid.

[10] Ibid.

electricity (-34.5 per cent) and gas (-4 per cent) compared with FY 22.[11] There was also an overall decrease in active retailers due to eleven retailer market exits.[12] No new retailer authorisations were approved in FY 23; the first time in several years.[13] It does not appear that the current market environment and regulatory settings are providing sufficient incentives for new retailers to enter the market to increase competition.

The removal of the competition allowance in DMO 6 has further reduced smaller retailers' ability to innovate and compete. If smaller retailers continue to exit the market, this would likely reduce the quality of service and options available to customers and decrease competitiveness, ultimately leading to higher bill prices for the consumer in the long-term.

Excluding the competition allowance from the DMO is likely an ineffectual lever to address cost-of-living pressures for consumers

The removal of the competition allowance from the DMO 6 price did not directly lower the retail electricity prices for the majority of customers. This is because approximately 90 per cent of residential and 80 per cent of small business customers are on market offers, rather than standing offers.[14] As will be discussed in more detail further in this submission, there are other measures that would be more effective in providing direct cost-of-living relief to customers that are facing payment difficulties.

A percentage-based allowance should be maintained, with consideration of forecasting risks

ENGIE supports a retail margin being set as a percentage of the DMO price. ENGIE has previously urged the AER to commit to maintaining the percentage level of the retail margin for a reasonable period of time to maintain regulatory certainty for all stakeholders.[15] From a consistency perspective, we were pleased to see that the AER is proposing to retain the 6 per cent and 11 per cent margins for residential and small business customers for a second consecutive year. Setting the allowance on a percentage basis ensures that it continues to provide for a DMO price that is at a relatively consistent level above competitive market offers. ENGIE supports the AER replicating the analysis carried out in DMO 6 using updated market offer data and costs.

A more objective and transparent methodology for the inclusion of the competition allowance should be developed

ENGIE considers the AER's framework for determining whether to include or exclude the competition allowance from the DMO 7 price is overly subjective. Specifically, whether CPI is 'materially' above the

---

[11] Australian Energy Regulator (AER), 2023, *Annual Retail Market Report 2022-23*. Link.

[12] Ibid.

[13] Ibid.

[14] Australian Competition and Consumer Commission (ACCC), 2023. *Inquiry into the National Electricity Market: December 2023 Report.* Link.

[15] ENGIE, 2024. *Submission - DMO 6 draft determination.* Link.

Reserve Bank of Australia's (RBA) target band for a 'sustained' period is open to interpretation, leaving retailers with inadequate certainty regarding whether competition allowance would be included or excluded in any given year. For instance, if inflation is reported at 3.1 per cent, it is unclear whether this would be considered 'materially' above the RBA's target band.

More broadly, ENGIE continues to question whether CPI is a useful indicator of cost-of-living pressures and whether households have sufficient capacity to manage their debt and expenses. The RBA has also highlighted that CPI is a suboptimal measure to assess changes in the cost-of-living. Among other limitations, the RBA notes that:

> *"The CPI is often used to measure changes in the cost of living, but it is not an ideal indicator of this. While the CPI measures price changes, cost-of-living inflation is the change in spending by households required to maintain a given standard of living."*[16]

ENGIE also notes that it unclear how the AER will assess the state of retail market competition in deciding whether to reinstate the competition allowance.

ENGIE notes that CPI is a lagging indicator and past inflation outcomes are unlikely to be reflective of the outcomes in the upcoming financial year. If the AER were to continue to rely on movements in the CPI as the primary factor for determining whether to include or exclude the competition allowance, ENGIE suggests that the AER consider instead assessing the RBA's inflation forecasts.

ENGIE continues to advocate that an appropriate competition allowance should include:

- A component that represents the headroom of the DMO and provides incentives for innovation and consumer engagement in the market; and
- An uplift to cover the risk of forecast errors that are not included elsewhere in the cost stack (e.g. risks introduced through the wholesale cost and network cost methodologies).

Government policy has proven to be an effective lever when providing customers with bill relief rather than the removal of the competition allowance

ENGIE contends that bill relief measures are most appropriately addressed using other levers, such as government policy. ENGIE notes that governments are currently acting to provide financial relief to consumers, such as through the Australian Government's July 2024 tax policy adjustments and the ongoing Energy Bill Relief program.[17] Governments also have access to other tools to directly address the cost-of-living pressures faced by vulnerable consumers, such as through adjustments to the rates and eligibility of concessions and rebates.

---

[16] Reserve Bank of Australia (RBA), 2024, *Inflation and Its Measurement*. Link.

[17] Department of Climate Change, Energy, the Environment and Water, 2024, *Energy Bill Relief Fund*. Link.

Another example of government policy targeting cost-of-living concerns was the Victorian Government's Power Savings Bonus (PSB) Program, which also intended to promote consumer engagement in the energy market.[18] To receive the one-off $250 bonus payment, applicants visited the Victorian Energy Compare website or engaged with an energy affordability service through a participating community outreach partner. The last two rounds of the program reached approximately two-thirds of Victorian households.

The PSB Program not only assisted vulnerable recipients with energy bill-related pressures but also enabled them to access additional support, such as concessions, best offers, and utility relief grants. This allowed recipients to allocate the bonus toward other urgent expenses, including rent and food as well as reduce their overall bill costs.

ENGIE and other retailers are currently and will continue to, support our customers living in hardship

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. Like many other retailers, ENGIE offers financial hardship support for its customers. In addition to our financial hardship services, we ran a program called 'Here to Help' in 2023 that provided hardship customers with payment matching and energy reduction incentives. Retailers already offer targeted assistance to vulnerable customers who need it the most.

Other DMO costs and considerations

Network costs should be based on a blend of flat rate, time of use (ToU), and other network tariffs

ENGIE contends that a blended approach would better reflect the costs that retailers incur, particularly as a growing number of customers are reassigned to TOU network tariff structures when smart meters are installed.

However, for small businesses with variable usage, accurately attributing costs could be challenging. The AER could consider establishing the average consumption profile of each network tariff and weight them by volume to derive a blended network cost estimate. While accommodating small business customers with TOU network tariffs is not currently a significant issue, because retailers have the ability to reassign small business customers to TOU retail tariffs, this may become a greater challenge for retailers to manage if the Australian Energy Market Commission progresses with its draft consumer safeguards flagged in the accelerating smart meter deployment rule change.[19]

---

[18] Victorian Government, 2024, *Power Saving Bonus – FAQ.* Link.

[19] Australian Energy Market Commission, 2024, National Electricity Amendment (Accelerating smart meter deployment) Rule 2024 – Directions paper. Link.

Concluding remarks

ENGIE looks forward to working actively with the AER to ensure that the DMO 7 adequately balances the DMO policy objectives to retailers to recover efficient costs and earn a reasonable retail margin, protecting customers from unreasonable retail electricity prices, and promoting healthy competition and innovation.

Should you have any queries in relation to this submission please do not hesitate to contact me by, telephone, 0400 731 274.

Yours sincerely,

Ronan Cotter

Ronan Cotter
Regulatory Advisor