

8 November 2024

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

By email: DMO@aer.gov.au**Default Market Offer prices 2025-26 Issues Paper**

Dear Ms Elkins and the DMO team

Energy Locals Pty Ltd (ACN 606 408 879) (**Energy Locals**) welcomes the opportunity to provide a submission to the Australian Energy Regulator (**AER**) in relation to the Default Market Offer (**DMO**) prices 2025-26 Issues Paper (**Issues Paper**).

In our submission, we have responded to the questions listed in Appendix A of the Issues Paper. Where we have not listed a question, we do not have a position or comment.

1. Background – overview of Energy Locals

Energy Locals is an authorised electricity and gas retailer that supports customers directly as well as via partnerships with newcomers to the energy retail sector, such as RACV, Indigo Power, RAA, Tesla, and others.

We also have extensive expertise in the implementation and management of embedded networks, which include electricity, gas, hot water, solar PV, electric vehicle charging, battery storage and telecommunications.

2. Wholesale costs**a. Net System Load Profile (NSLP) and interval meter data**

Question 1: Which option do you prefer and why?

Energy Locals does not support either option proposed in the Issues Paper as we strongly disagree with the approach of excluding solar exports in the customer load profiles to model wholesale costs. Of the options presented, we prefer option 2 as it enables solar exports to be included. However, we consider that interval meter data is more reliable and accurate than the NSLP.

As noted in the Issues Paper, there are several limitations to using the NSLP, particularly concerning data accuracy. Additionally, the NSLP does not accurately reflect actual loads, as it includes C&I customers (who are not subject to the DMO), resulting in a more flattened load profile.

Given that wholesale costs in the DMO are to be informed by the hedging strategy of a prudent retailer, it is important for the AER to consider recent changes in hedge provider methodologies. [REDACTED]

[REDACTED]

In summary, Energy Locals supports a methodology that most accurately reflects reality. By excluding solar, the current load profiles in the DMO do not align with actual usage patterns. We therefore reiterate our position, as expressed in previous submissions and discussions with the AER, that the impact of solar exports must be included in load profile assumptions as they have a direct and material uplift on wholesale electricity costs.

Question 3: Do you have access to, or know of, any data which highlights the difference in the consumption profile of accumulation and interval meter customers, excluding the impact of solar exports?

To identify the difference in the usage profile of accumulation and interval meter customers, we suggest the AER explore the ability of the Australian Energy Market Operator (**AEMO**) to provide load profiles which exclude commercial and industrial (C&I) customers. In comparing this data, we expect that the AER will be able to get an overview of the small business and residential combined load which is more relevant in setting the DMO. We again reiterate that the impacts of solar exports should not be excluded.

Question 4: If you are a retailer, are you making changes to your hedging strategies or positions in light of AEMO's third adjustment to the NSLP?

Our hedging strategy is not influenced by AEMO's third adjustment to the NSLP.

Question 5: If you are a retailer, do you use AEMO's NSLP in your hedging strategy, and if so, how do you weight it alongside any other data sources for example, your own customer book?

[REDACTED]

Question 6: Given issues with the available load profile data, should the AER determine separate load profiles and associated wholesale cost forecasts for residential and small business customers? Are there factors we should consider, depending on which load profile data option is used?

[REDACTED]

b. Controlled Load Profile (NSW)

Question 7: Which option do you prefer and why?

We believe that the actual controlled load interval meter data should be used. As above, we think it's crucial for all data points used to be reflective of the way in which hedge providers price the shape of small customer load.

¹ [REDACTED]

Question 8: If you are a retailer, are you making changes to your hedging strategies or positions in light of the removal of the NSW controlled load profiles?

No, our hedging strategy will not be influenced by the removal of the NSW controlled load profiles.

Question 9: If you are a retailer, do you consider AEMO's CLP in your hedging strategy, and if so, how do you weight it alongside any other data sources for example, your own customer book?

We do not rely upon AEMO's controlled load profile.

c. Solar PV exports and hedging costs

Question 14: What are your views on whether the AER should consider accounting for any additional hedging costs arising from customers' solar exports?

The AER has explained that given interval meter dataset can be split into customers' imports and solar PV exports, a decision was made to exclude it within the blended load profiles.² We fundamentally disagreed with the decision to exclude solar exports from DMO 6 and maintain that the AER's rationale that solar exports be excluded on the basis that "the DMO seeks to set a price for customer consumption"³ is inherently flawed.

While we acknowledge the AER's recognition of the concerns raised by retailers in DMO 6 regarding the impact of solar exports on hedging, we strongly reiterate that solar exports should be included in all load profile assumptions. Prudent retailers hedge based on their net load, which includes both customer imports and solar exports.

The specific shape of solar exports significantly impacts the overall net load that retailers - especially those supporting rooftop PV and the energy transition - are required to hedge. Negative spot price periods typically occur when solar generation is at its highest during the day. This means that if a retailer becomes a net generator during those periods they are incurring a direct uplift in their wholesale expense without actually purchasing additional power. This is a real, observable cost and should not be excluded. We therefore strongly believe an allowance should be made for this in DMO 7.

The frequency of negative spot prices has been increasing year-on-year, and this is becoming a key contributor to rising wholesale costs. These periods of negative pricing are difficult for a prudent retailer to hedge against as traditional risk management instruments do not insure against these risks. To illustrate the growing frequency of negative spot prices, we have included a table below showing the count of negative spot price intervals between 30 September and 29 September over the past two years.⁴

STATE	30/9/2022 - 29/9/2023	30/9/2023 - 29/9/2024
NSW	5701	7915
QLD	11428	15511
SA	25979	25163

² Australian Energy Regulator, Default market offer prices 2025–26 - Issues paper, p. 21.

³ Ibid.

⁴ This data was taken from Iguanalytics based on AEMO spot price data on 6 November 2024.

⁵ _____

d. South Australian wholesale methodology

Question 15: Further to analysis of OTC contract information, are there other methodologies the AER could investigate to benchmark wholesale cost forecasts in South Australia?

We do not consider a new methodology is required to benchmark wholesale cost forecasts in South Australia. The combination of futures and actual OTC trades continues to be the fairest way to benchmark wholesale costs. Whilst the volumes may not be large, it is reflective of what a retailer is actually paying.

Question 16: Should the AER repeat the LRMC analysis for DMO 7 as a comparative data point for wholesale energy costs in South Australia?

Energy Locals does not consider it necessary for the AER to repeat the long-run marginal cost (**LRMC**) analysis. It would be difficult for a small retailer to hedge to a LRMC, and it may create gaps between actual and assumed hedging costs.

3. Retail costs

Question 19: Do you consider these current methodologies appropriate and, if not, what alternatives should be considered?

We are supportive of the AER maintaining the same “cost stack” methodology with a broader data set. It is imperative that the methodology considers recent data.

Question 20: What additional operational considerations or capital expenditure costs should the AER consider in determining the cost recovery of advanced metering costs?

In considering metering costs, we encourage the AER to read our two submissions⁶ to the Australian Energy Market Commission (**AEMC**), in which we have outlined our concerns on the financial burden for retailers in connection with the proposed smart meter rule changes. At a minimum, the AER must factor the following into the calculations of *retailer costs and margin*:

- the number of meters specified for replacement during the relevant periods in the Legacy Meter Replacement Plans (**LMRPs**);
- the realistic annual cost of the current proportion of smart meters;
- average fees charged by metering providers for smart meter replacements;
- the distributor costs of the remaining basic meters; and
- the system upgrade and administrative costs required for retailer compliance, which will include planning and engaging metering providers to deliver against the LMRPs, amending systems and templates to meet new notification requirements and training staff on the new requirements.

Implementing the proposed consumer safeguards will be resource-intensive and will add to the already significant cost burden retailers face as part of the smart meter rollout. A major cost to retailers will be the inability to pass on network costs, which will unfairly place the burden of these costs solely on retailers, despite the involvement of many other participants in the national energy market. In this regard, the proposed three-year period of explicit informed consent (**EIC**) is excessive.

While outside the remit of the DMO, we urge the AER to progress regulatory changes that would restrict distributors from changing the tariffs if a retailer is unable to pass on the same network tariff to a customer.

⁶ Energy Locals submission to AEMC - Draft rule determination - National Electricity Amendment (Accelerating Smart Meter Deployment) Rule – Submission – dated 30 May 2024 and Energy Locals submission to AEMC - Directions Paper - Customer Safeguards – Accelerating Smart Meter Deployment – 12 September 2024.

After all, we see little point in the AER requiring cost reflective tariffs if the price signals contained therein are hidden from customers.

In any event, we consider that future DMOs must include adjustments to reflect these retailer costs. This is particularly important if the timeframes in the acceleration period do not neatly align with the DMO.

4. Retail margin and allowance

While Energy Locals is supportive of a delineation between the retail margin and competition allowance, we strongly disagree with the logic to exclude the competition allowance based on economic conditions. The competition allowance remains important to incentivise and ensure competition.

Question 21: Do you consider the proposed retail margins appropriate and, if not, what alternatives should be considered?

As raised in our submission to DMO 6, our preference for the retail margin is a fixed rate dollar amount to provide greater certainty to retailers.⁷ In this regard, we considered that the DMO 6 margin of 6% and 11% for residential and small business customers was too low.

We agree that further analysis should be performed to determine what margin values are appropriate and we therefore expect to have more substantive comments once the draft determination is shared.

With regard to what considerations should be made when setting the retail margin, we reiterate our position to the DMO 6 draft determination that economic conditions should be considered for all elements of the “cost-stack” to ensure that the retail margin is appropriate. This is particularly important if economic factors will determine whether a competition allowance is included.

For example, rising inflation and cost of living pressures will likely prompt a continued rise in bad and doubtful debt. Similarly, salaries and wages are a major part of a retailer’s operating costs and current inflation levels, and interest rates, also have a direct impact on that cost.

Energy Locals also considers that the DMO should factor in allowances for adjustments for cost differentials incurred by retailers to ensure the efficient margin is achievable. In setting the retail margin, the AER should factor in allowances for wash-ups to accommodate any errors in the assumptions made for environmental and network costs.

Question 22: What is the most appropriate approach to incorporating a diverse range of retailer costs to serve in DMO prices?

We support the proposed approach of obtaining data from a large cohort of 25 retailers through a retail cost information request.

In considering this data, there must be an acknowledgement that costs differ substantially for smaller retailers in comparison to large retailers. A limitation of using a weighted average is that the retail costs of the largest four retailers will be far lower than smaller retailers. A weighted average would therefore not be representative of all retailer costs. By way of example, smaller retailer will likely have higher costs from metering providers, given the negotiating power of customer numbers will be more limited.

The difficulty in calculating an average to reflect a diverse group of retailers is another reason why a margin is needed to ensure smaller retailers and new entrants to the market can maintain a profit.

⁷ Energy Locals submission to the Australian Energy Regulator, DMO 6 Issues Paper, 3 November 2023.

Question 23: What other factors, if any, should the AER consider in deciding whether to apply the competition allowance?

While we acknowledge the rising cost of living pressures on consumers, we strongly disagree with the decision to exclude a competition allowance based on economic conditions. A competition allowance should always be factored into the DMO, as one of its core objectives is to “maintain incentives for competition, innovation and investment by retailers and incentives for consumers to engage in the market.”⁸ Excluding market competition from consideration, despite it being a central aim of the DMO, sends the wrong message to market participants.

Furthermore, we reject the assertion that the approach is “transparent, objective, and provides predictability about how economic conditions will be addressed.”⁹ Even if an economic link is accepted, the criteria for applying the allowance is unclear. Instead of a vague reference to a range “materially above the Reserve Bank of Australia’s (RBA) target band (of 2-3%)”¹⁰ and an undefined “sustained period,”¹¹ there should be a clear and specific CPI percentage, with well-defined criteria for what constitutes a “sustained period.”

In considering whether to apply an allowance, regard must be had to the risks faced by a new entrant rather than that of an established large retailer. In any event, there needs to be an acknowledgment that retailers are facing a lot of costs incurred with a complex and ever-changing regulatory framework.

Regardless, we believe that federal and state governments have many other tools at their disposal to assist with the impact of increased inflation. We would like to see targeted measures rather than a blanket removal of the competition allowance, while simultaneously requiring retailers to cover increased costs as a result of the energy transition and regulatory changes.

5. Other DMO costs and considerations

Question 24: Should network costs be based on a blend of flat rate and time of use network tariffs and why or why not?

As per our comments above, it is imperative that the network costs reflect what the networks are doing in practice. We therefore consider that the AER should obtain data directly from the networks and calculate the network costs based on the tariffs set by each network. Obtaining data from a retailer could present a mismatch. In this regard, we urge the AER to closely monitor the smart meter deployment rule changes. If the proposed customer protections restricting retailers from passing on cost reflective tariffs without explicit informed consent are implemented, retailers will be commercially disadvantaged, and this must be reflected in the DMO.

Question 25: What are your views on whether the AER should consider adopting new annual usage amounts? What alternative sources should be considered, and/or what values would be more broadly representative than the current assumptions?

In setting the DMO, we consider it essential for the AER to critique and review previous assumptions to ensure it remains accurate. To ensure accuracy, real data should be used, although we don’t have a preference from the myriad of different data sources that the AER could choose from.

⁸ Australian Energy Regulator, Default market offer prices 2025–26 - Issues paper, p. 4.

⁹ Ibid, p.30.

¹⁰ Ibid.

¹¹ Ibid.

Question 26: What benefits do you see in further consideration of improvements to the methodology of timing and pattern of supply? How material may this be and how could we address any additional complexity it causes?

As outlined in our submission to DMO 6, we consider the key assumptions for timing and supply usage profiles require revision. Specifically, there should be distinct variations for weekdays versus weekends, as well as seasonal adjustments. Energy usage is influenced by a range of factors, meaning it can vary considerably from day to day and between customers. While the assumed usage patterns have remained static over recent years, actual consumption trends have shifted significantly. This change is driven by factors such as the increased adoption of controlled load appliances, solar panels, batteries, and electric vehicles.

We therefore support further consideration and analysis being performed to the methodology of timing and pattern of supply. We expect that we will be able to provide more constructive feedback on the analysis and discussions with AEMO in the Draft Determination.

6. Summary of Energy Locals' position

In summary, Energy Locals reiterates its positions raised in response to the DMO 6. Of note, we urge the AER to ensure that solar is represented in the load profile assumptions.

We also stress that the AER must consider the full spectrum of retailer costs, including those arising from the smart meter rule changes and other regulatory changes, when determining appropriate pricing allowances.

We support the AER's approach of obtaining data on retailer costs. As smaller retailers face higher costs comparative to larger retailers due to their limited scale, it is crucial to ensure that the retail margin is set at a level that allows for competitive and sustainable operations for smaller retailers and new entrants in the market.

We consider it essential for the AER to incorporate a competition allowance in the DMO regardless of economic conditions. Retailers are operating in an increasingly complex environment, facing significant regulatory and financial challenges, which must be factored into any decisions regarding the DMO.

We expect that we will have more constructive feedback on methodologies used in the DMO 7, once the external consultant, ACIL Allen, has prepared its reports alongside the draft determination.

Energy Locals thanks the AER for the opportunity to provide our feedback in this submission, and during the recent retailer workshop. We look forward to continuing to engage in discussions once the draft determination for DMO 7 has been released.

We are very happy to discuss any aspect of our submission at any time.

Yours faithfully,



Adrian Merrick
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Energy Locals Pty Ltd