



EnergyAustralia

LIGHT THE WAY

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AER Default market offer prices 2025-26 Issues paper – Public VERSION

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts across eastern Australia. We also own, operate and contract a diversified energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 5,000MW of generation capacity.

EnergyAustralia welcomes the opportunity to make this submission to the AER's Issues Paper on the Default Market Offer for 2025-26 (DMO7). Overall, we strongly encourage the AER to adopt a long-term perspective when setting the DMO price.

Stability in the DMO methodology is essential

Each year the AER has introduced changes to the DMO methodology. By contrast, the VDO methodology has maintained relatively stable over recent years. Frequent shifts in the DMO approach can undermine market stability, making it more complex for retailers to plan operations, and for consumers to trust in consistent DMO pricing over time.

History of past DMO decisions shows that once the AER introduces a change to the DMO methodology it has yet to revert it; for example the removal of the glide path in South Australia and changing from the 95th percentile to a 75th percentile in the wholesale approach. This raises questions about whether issues addressed in previous decisions and included in the issues paper are truly being considered or if these adjustments are, in effect, permanent changes. We would value greater direction from the AER going forward if aspects of the methodology are not actively under review. This would streamline engagement on changes only where new or compelling evidence supports reconsideration.

Consistency and including a margin of error are key to a resilient DMO

Historically, the changes introduced to the DMO methodology have also typically revised the allowable costs downwards - addressing concerns with affordability and cost of living pressures. However, in a sector of rising costs due to the energy system transition, there is a limit to such revisions before the DMO price fundamentally fails to maintain the necessary incentives for retail competition. This will erode consumer choice and competitive tension in the market.

Our concern with the AER's approach in the DMO6 is that retailers bear the risk of rising network costs, - risks likely to grow as the energy transition progresses, as we have raised previously. Without a provision or 'buffer' built into the DMO price, DMO decisions risks compromising retailer viability – particularly smaller retailers with higher operating costs.¹

Framing the DMO price setting as a question of whether retailers value accuracy versus consistency mischaracterises our core concern. Both accuracy and consistency are important; we are primarily concerned that consistent changes to the DMO, which have typically resulted in downward cost revisions, reveal a preference for outcomes that reduce the DMO price to the lowest level. While we agree that a DMO price can reasonably represent a theoretical or 'notional' retailer with moderate costs, mathematically, there will always be a margin of error. This needs to be factored into the current methodology (or reinstated, as the case may be).

This margin of error could be addressed through various ways in the DMO price setting. For example, simple approaches include revisiting:

- An adequate competition allowance, which serves as a critical buffer for under-recovery in other parts of the cost stack. Smaller retailers, which often incur higher operating costs, and retailers with greater depreciation and amortisation, may rely more heavily on this allowance to remain competitive.
- A more conservative wholesale approach, such as reverting to the 95th percentile. This would help ensure the DMO price remains resilient against price fluctuations and aligns more closely with real-world challenges that retailers of all sizes face.

Some changes being explored in the issues paper reinforces a pursuit of 'false precision'. For example, the AER seeks to improve DMO inputs (e.g the load profile) and better account for real underlying costs - but the DMO outputs (e.g optimised hedging strategy) are theoretical, and unattainable by retailers in real world conditions (e.g a hedging strategy based on perfect foresight). This emphasises the importance of building a sufficient buffer into the DMO price setting to account for a margin of error that address inherent uncertainties and risks that retailers face in the real world. The pursuit of "accuracy" that continually reduces allowable costs risks reinforcing a 'false precision' that erodes market diversity and ultimately restricts consumer options.

¹ See for example, Figure C8.6 at Appendix C and Figure C8.8 at Appendix D; ACCC, [Inquiry into the National Electricity Market: December 2023 Report](#), Appendix C.

The DMO is intended to be a safety net price, not the lowest available offer

The intended purpose of the DMO was to serve as a safety net price, rather than the lowest offer available to consumers. ACCC analysis seem to indicate that the DMO is already at levels that challenge retailer sustainability.² Market offers clustering around the DMO/VDO price in recent years seem to indicate that offering lower rates below DMO/VDO prices is challenging for retailers to sustain. This clustering - along with the reduction in discounts in offers and increased offers above the DMO/VDO suggest that retailers are finding it challenging to offer significantly lower rates.

The Australian Energy Market Commission (AEMC) previously cautioned that setting the DMO too low could create a scenario where retailers are constrained, leading them to set market offer prices close to or above the default price to recover costs.³ For retailers, especially smaller ones with higher costs, the DMO price can be difficult to meet profitably, leading to a narrowing of price options available to consumers.⁴

Long-term implications for retail market competition should be considered

Retailer margins have reached historical lows based on the ACCC dataset.⁵ EnergyAustralia reported impairments that reflect declining margins and higher costs from increased retail competition⁶ —a concern with potentially greater implications for smaller retailers with higher costs.

In assessing traditional competition metrics on whether the AER will apply a provision for competition, we encourage the AER to question:

- What market offers they are examining to assess the state of retail competition and what kinds of retailers are making the offers?
- What kind of retailer is entering the retail market?
- What kind of retailer has exited the retail market?
- Does this represent the mix of participants that the AER want to see for effective retail competition that will benefit consumers over the longer term and during the energy system transition?

We see short term affordability targets via shifts in the DMO price setting comes at a cost of long-term objectives of maintaining competition. To address immediate affordability concerns, governments have introduced energy bill relief measures designed to help households and businesses manage cost of living pressures. The competition allowance within the DMO should not

² ACCC, [Inquiry into the National Electricity Market: December 2023 Report](#), p47; see also Figure 3.2 at Appendix A.

³ AEMC, [Customer and competition impacts of a default offer, 20 December 2018](#), p V.

⁴ Ibid.

⁵ ACCC, [Inquiry into the National Electricity Market: December 2023 Report](#), p34; see also Figure 2.12 at Appendix B.

⁶ EnergyAustralia, [EnergyAustralia Earnings Update](#), 30 January 2024.

be about short-term relief but about ensuring the long-term sustainability of the DMO offer and supporting a market where retailers can sustainably provide competitive and innovative offers. The ACCC emphasises the need to ensure retailers can compete under the DMO settings and submitted that:⁷

A well-functioning and competitive retail electricity market will be important to support the interests of electricity consumers through the energy transition. A competitive retail market will encourage competitive pricing conduct as well as the development of new and innovative retail market products that support evolving consumer needs and wants as patterns of electricity generation and usage evolve...

Providing sufficient incentive for competition in retail electricity markets is an important consideration for the AER to ensure that competition continues to deliver in the interests of consumers. We consider that, where competition is workably competitive, market forces provide more effective protection to customers compared to regulation.

Our full submission with responses to key questions in the issues paper is in the **Attachment**.

If you have any questions in relation to this submission, please contact me (maria.ducusin@energyaustralia.com.au or 03 9060 0934).

Yours sincerely,

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⁷ ACCC submission, [DMO 6 draft determination](#) Implications of change in methodology for retail allowance in DMO6 for retail competition over the longer term, 9 April 2024, p 1.

1. Wholesale methodology - Net system load profile and interval meter data

Which option do you prefer and why?

As noted, we are concerned that consistent changes to the DMO methodology, which have reduced allowable costs indicates a bias for options that result in the lowest-cost outcomes.

Our response to this question is based on the understanding that changes to the NSLP dataset warrant a practical review in DMO7. However, without detailed analysis or further data on the assumptions for each option, it is difficult to fully assess their implications based on the status quo.

Given the 3 options presented on the load profile, and short of seeing the interval meter data or understanding the assumptions used to create the load profile, we lean towards option 1 - using 2 years of interval meter data only to simulate the load profile, rather than blending with the NSLP. We understand from the AER that this option will include the use of all interval meter data available over the two-year period, and not a subset of the data. Our leaning for Option 1 is contingent on the AER including all peak and non-peak periods in the dataset without alterations and the AER including all interval meters. Option 1 appears to benefit from being more 'future proof' than the other options that will require adjustments in future DMO decisions, thereby supporting greater consistency going forward.

Broadly, option 1 also seems to avoid the complexity and potential inaccuracies in blending two different data sets, which appears to be an issue in the other two options. As smart meter adoption expands, interval meter data will increasingly reflect the usage of the broader customer base, though we acknowledge that, in the short term, this approach will not fully capture usage patterns of customers on accumulation meters. We also note that the AER will have greater visibility on smart meter penetration given the updates to the AER Retail Market Performance guidelines which will capture this information.

Given the impact that interval meter data has on shaping load profiles, retailers would benefit from a clear understanding of how assumptions are applied to this data to determine the load profile used for the DMO.

We do not have strong views on separating load profiles for residential and small business customers, as previously stated. Our preference for regulatory consistency would be to maintain the current approach.

1.1. Wholesale methodology - Controlled Load Profile (NSW)

Which option do you prefer and why?

Given the 3 options available, and consistent with our view above, we lean towards Option 3 – using the WEC for residential flat rate customers, if interval meter data is adopted. This appears to

avoid the need for approximations that are inherent in using a historical controlled load profile or a blended profile. Further, it seems to avoid the complexity of blended profiles and the potential for errors in weighting the different profiles. In contrast, option 3 uses actual interval data that reflects real consumption, avoiding the need for possibly arbitrary blending decisions.

1.2 Solar PV exports and hedging costs

What are your views on whether the AER should consider accounting for any additional hedging costs arising from customers' solar exports? If you are a retailer, how does the presence of customers' solar exports impact your hedging strategy and how could these additional costs be quantified within the wholesale methodology?

A purist approach would exclude solar exports, aiming for the DMO to represent only the cost of supplying grid consumption. However, this can overlook the complexities retailers face. If the DMO methodology were fully consistent - the purist approach would make sense, but as it stands the methodology reflects a mix of actual retailer costs (e.g retailer operating costs) and theoretical outputs and assumptions (e.g an optimised wholesale hedging strategy). Upholding a purist approach risk reinforcing a level of 'false precision' that does not align with market realities. Changing methodology to include solar in the load profile (i.e net off solar) may better align the model with net demand that the DMO retailers manage, thereby offering a more accurate reflection of the hedging costs retailers face in a high-solar environment.

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Solar exports add volatility, especially during negative pricing events, which increases the cost of managing risk. Overall, we consider this should be accounted for in the DMO price setting. While provision can be made to account for these costs in other aspects of the DMO, one could argue that the simpler and cleaner approach would be to reflect this in the load profile itself. Aligning the DMO methodology with the VDO approach, which nets off solar exports would - at the very least introduce regulatory consistency. Further, it would seek to better reflect hedging practices - focusing on market-based exposures.

1.3 South Australian wholesale methodology

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

As previously raised, the AER may want to consider the use of broker curves, which could be an improvement for the AER. Broker curves often take into account over-the counter (OTC) activity and inter-regionals and can be a higher integrity mark for illiquid products.

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

While we acknowledge that contract liquidity in South Australia is low, we believe that the continued use of the ASX is preferred given it provides a transparent and established measure for hedging costs. As a sense check, it may be worthwhile for the AER to continue benchmarking ASX contract prices against OTC and LRMC analysis. This will allow the AER to examine whether contract liquidity presents a material issue affecting hedging practices. That said, we consider any comparative data points, including LRMC, should serve as comparative checks rather than primary inputs. Industry consultation will be especially important before any sudden changes to the methodology are considered.

1.4 Inputs into wholesale modelling

Would any of our modelling inputs specifically benefit from additional variability? If so, what objective data sources could be used to inform the creation of additional inputs?

The cost-base model used by the AER does not fully capture the volatility that exists in real-world market conditions. This is particularly relevant in the short-term, where single fuel prices and external shocks can lead to significant fluctuations.

We recognise that introducing variability into modelling inputs may help better reflect the cost variations in the duration curve, but it may not necessarily produce the kind of competitive tension seen in real-life markets. The market reflects a dynamic interaction of numerous factors, not just cost, making it hard for any cost-based model to fully capture this complexity.

Overall, we are unsure whether adding this complexity into additional variability will improve outcomes. If the AER does choose to add more variability in modelling inputs, we ask the AER to specify the limitations of the variability being introduced. This means outlining clear bounds for the additional inputs, whether they introduce low, medium, or high variability into the model. We recommend a range should be defined (+/- bounds) to specify the expected variability in the inputs. Doing this will allow stakeholders to understand the uncertainties involved.

Other comments

It is our belief that the wholesale methodology assumes a cap pay out every year. So in the DMO wholesale cost modelling – after running simulations, prices are run against a hedge strategy. If a retailer is long to high prices the retailer receives a windfall gain which reduces the average cost. If there is no volatility – there is no cost saving or windfall gain. While the concept of cap payouts holding over the long term may be valid, a prudent retailer does not assume any particular year will yield a return on a cap contract. Rather, cap contracts function as an insurance product for retailers.

We believe this assumption warrants further examination to understand why it should apply in DMO wholesale modelling.

2. Network cost methodology for small business and other considerations

Should network costs be based on a blend of flat rate and time of use (ToU) network tariffs and why or why not? How could the issues above be overcome – particularly for small business network tariffs – if we were to create a blended cost?

We lean towards maintaining the current approach of using flat-rate tariffs only.

The proposal to blend ToU and flat-rate tariffs for small business customers raises questions about complexity and practicality. It is unclear if blending will improve the accuracy of the DMO price setting or how the AER intends to execute it effectively. We're particularly concerned about the availability and quality of data to support this change.

Calculating a blended rate that combines ToU and flat tariffs would require additional and reliable data on small business consumption profiles, complicating the DMO price-setting process. We caution against this as it introduces complexity and lack of stability in the methodology leading to possible year-on-year calibrations to maintain accuracy.

A simpler approach that avoids this complexity is to incorporate a margin of error. This would also effectively address potential concerns around smaller retailers, who often face higher per-customer operating costs and may find it challenging to absorb ToU network costs without reflecting them in the DMO price for small businesses. By ensuring a buffer is built into the DMO price, the AER could provide a more stable and realistic framework for retailers, regardless of size, to compete effectively in the market.

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?

The AER's current approach to setting annual usage amounts is sufficiently accurate and representative, and we support the existing methodology. Usage assumptions remain close to real-world averages and appropriately balance simplicity with representativeness.

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?

Given that the methodology is based on benchmark usage, the current approach to the methodology of timing and pattern of supply remains broadly sound and practical. That said, we support the AER working with AEMO to remove controlled load (CL) from the main profile only. Figure 6.1 in the AER's issues paper illustrates the effect of removing CL from the overall main profile, showing lower usage overnight and increased usage during the day. We consider this usage representation reasonable and do not see the need for additional profiles with or without CL, nor do we consider seasonal adjustments necessary.

3. Retail cost methodology – cost to serve and cost to acquire and retain customers

Do you consider these current methodologies appropriate and, if not, what alternatives should be considered? What is the most appropriate approach to incorporating a diverse range of retailer costs to serve in DMO prices?

We support continued use of actual retailer data in setting the retail cost methodology. That said, a customer-weighted average approach, even if it draws from a broader cohort of retailers including smaller retailers can still mask the variability in costs – particularly smaller retailers with higher per-customer costs.⁸ Using the unweighted median could partially address this by reducing the influence of larger retailers. However, this has limitations as it does not account for high cost-smaller retailers that fall above the median, potentially leaving their cost pressures still under-represented.

One suggestion could be to combine the median approach of retailer costs with a margin of error built into the DMO price setting. This could:

- address the limitations of a customer-weighted average and better represent smaller retailer costs
- avoid reinforcing a 'false precision' in capturing these costs, and
- support long term stability and resilience in the DMO price setting.

3.1 Retail cost methodology – smart meter costs

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

⁸ See for example, Figure C8.6 at Appendix C and Figure C8.8 at Appendix D; ACCC, [Inquiry into the National Electricity Market: December 2023 Report](#), Appendix C.

In our previous submission, we provided detailed feedback on smart meter costs in light of NSW network metering changes. We are pleased to see the AER adopted our recommendations and support the AER's consistent approach to applying these considerations in SA and QLD for DMO7.

4. Retail margin and allowance

Do you consider the proposed retail margins appropriate and, if not, what alternatives should be considered? What other factors, if any, should the AER consider in deciding whether to apply the competition allowance?

Our submission advocates for stability and including a margin of error are key to a resilient DMO price-setting framework. This could be addressed in various ways including by applying the competition allowance.

A retail margin based on the percentage of the DMO cost stack remains sensible and reasonable. However, the current margins alone may not adequately capture the full range of operational and cost challenges faced by a retailer, especially those with higher per-customer costs. As discussed, a critical margin of error built into the DMO addresses this issue and provides benefits - including:

- **Sustaining market diversity.** According to the ACCC smaller and new retailers play a crucial role in fostering competitive and innovative offerings but face higher operating costs without the economies of scale available to larger providers.⁹ A competition allowance to account for these costs would promote a diverse mix of retailers, benefiting consumers with more choices, innovation¹⁰ and tailored products.
- Logically, it follows that collecting a broader dataset of retailers to capture diverse retail cost structures, including those of higher-cost smaller retailers, should be accompanied by a competition allowance. This would ensure that the DMO price setting supports a competitive retail environment and does not place an undue burden on smaller retailers.
- **Promoting long-term viability.** ACCC findings indicate current DMO levels may already challenge retailer sustainability, with clustering around the default price and fewer deep discounts.¹¹ A competition allowance or some buffer would help mitigate the risk of reduced consumer choice over time due to potential retailer exit, enhancing consumer protection.
- The ACCC's considers that well-functioning market forces can better protect consumers than strict regulatory caps,¹² reinforcing the importance of a balanced margin approach.

⁹ ACCC submission, [DMO 6 draft determination](#) *Implications of change in methodology for retail allowance in DMO6 for retail competition over the longer term*, 9 April 2024, p 1.

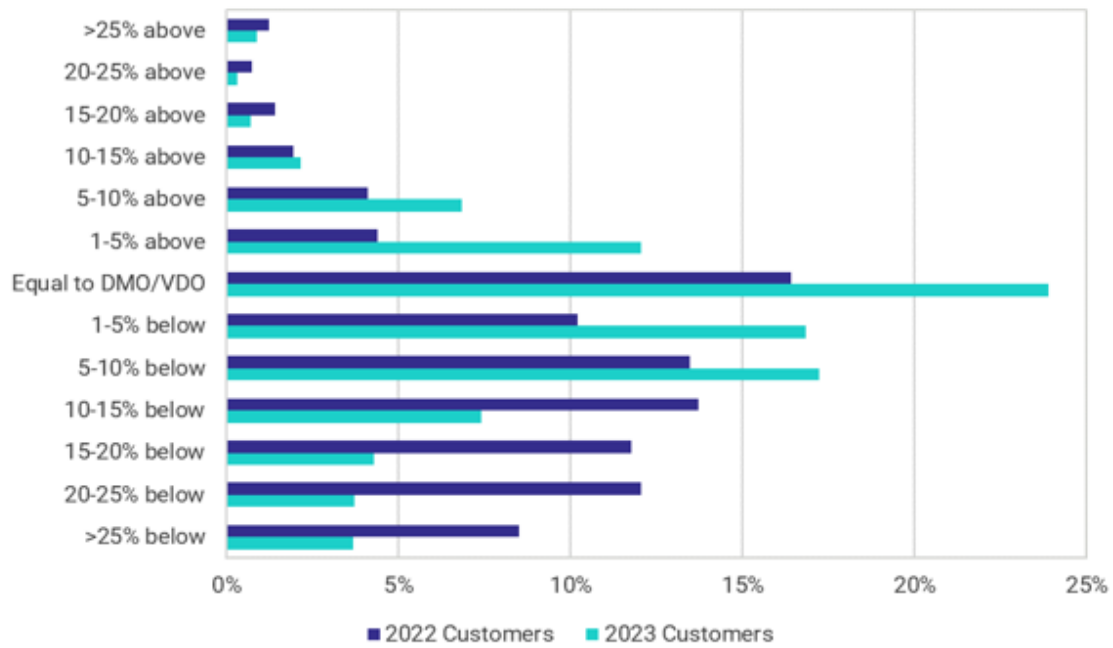
¹⁰ On innovation, subscription tariffs and predictable plans, were examples of innovative structures previously offered - see AEMC, [Customer and competition impacts of a default offer, 20 December 2018](#), p 40. These examples in the AEMC paper appear to have since been discontinued, highlighting the challenges that innovative pricing models may face in a highly regulated market.

¹¹ ACCC, [Inquiry into the National Electricity Market: December 2023 Report](#), p47; see also Figure 3.2 at Appendix A.

¹² ACCC submission, [DMO 6 draft determination](#) *Implications of change in methodology for retail allowance in DMO6 for retail competition over the longer term*, 9 April 2024, p 1.

Appendix

Appendix A: Figure C10.2 (Figure 3.2 in report): Proportion of residential customers on flat rate plans paying more, equal to, or less than the DMO/VDO assuming 100% achievement of conditional discounts



Source: ACCC analysis of retailers' data.

Key take outs:

1. Offers centring around the DMO/VDO price point

- The percentage of offers 'Equal to DMO/VDO' increased from 14% in 2022 to 21% in 2023, showing a clear movement towards the DMO/VDO price.
- Also, offers within a small margin (1-5% below the DMO/VDO) have increased from 9% in 2022 to 19% in 2023.

2. A reduction in deep discounts:

- The proportion of offers more than 10% below the DMO/VDO decreased from a total of 52% in 2022 (sum of >25%, 20-25%, 15-20%, and 10-15% below) to 19% in 2023, suggesting fewer low-priced offers.

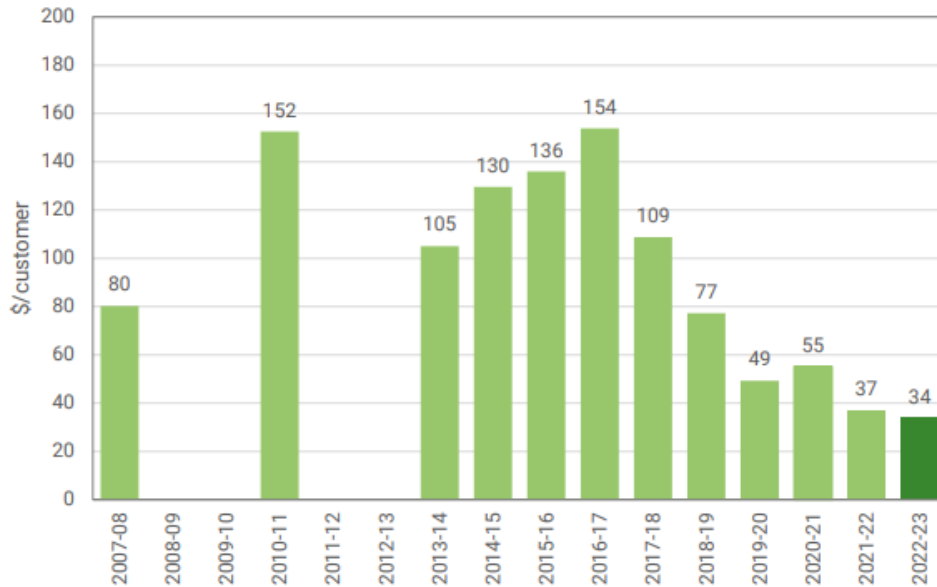
3. More offers above the DMO/VDO

- Offers slightly above the DMO/VDO (1-5% above) increased from 4% in 2022 to 12% in 2023, indicating upward pressure on prices.

Appendix B:

Figure 2.12 National Electricity Market-wide retail margins in 2022–23 declined slightly to the lowest in our timeseries

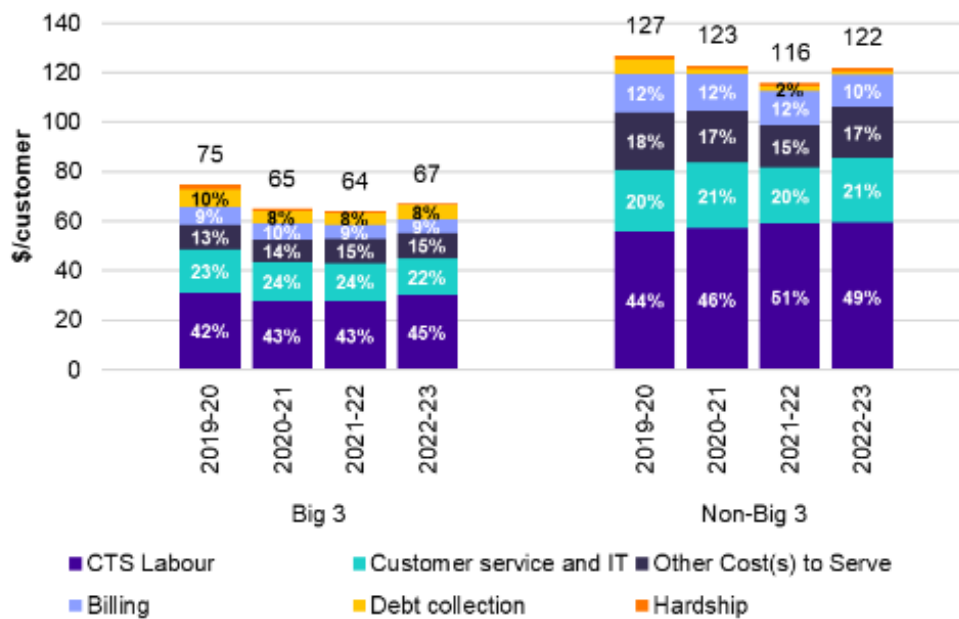
Average retail margins (earnings before interest, tax, depreciation and amortisation) per residential customer across the NEM, 2007–08 to 2022–23, real, excluding GST⁴²



Source: ACCC analysis of retailers' data.

Appendix C:

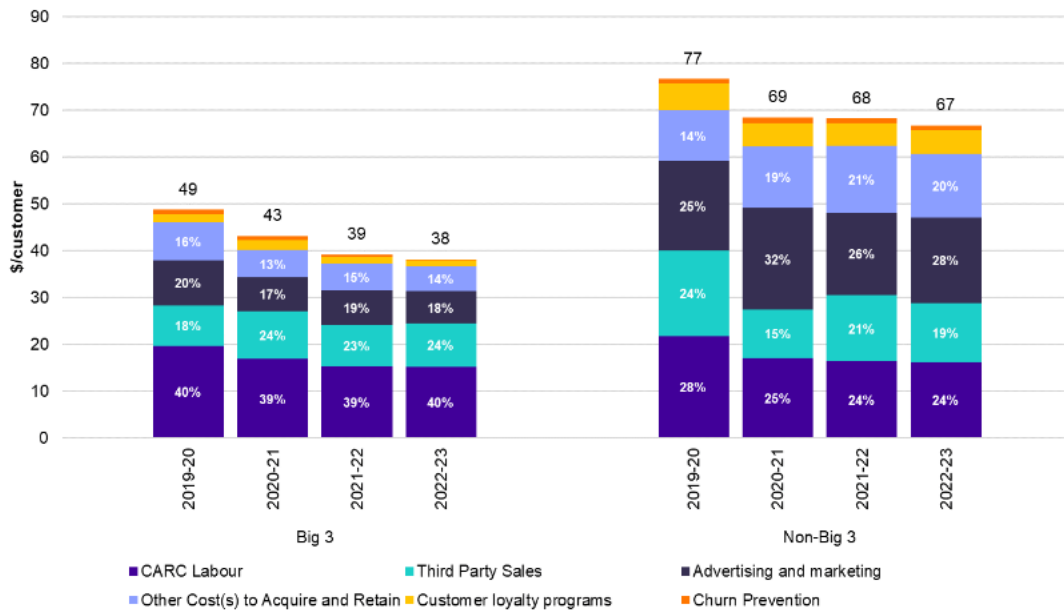
Figure C8.6: Average Cost to Serve per residential customer across the NEM by retailer tier, 2019-20 to 2022–23, real \$2022-23, excluding GST



Source: ACCC analysis based on retailers' data.

Note: Data labels for small cost components have been omitted for readability. CTS = Cost to serve.

Appendix D: Figure C8.8: Average Cost to Acquire and Retain per residential customer across the NEM by retailer tier, 2019–20 to 2022–23, real \$2022–23, excluding GST



Source: ACCC analysis based on retailers' data.

Note: Data labels for small cost components have been omitted for readability. CARC = costs to acquire and retain.