PO Box 4136
East Richmond VIC 3121
T 131 806
F 1300 661 086
W redenergy.com.au

PO Box 4136
East Richmond VIC 3121
T 1300 115 866
F 1300 136 891
W lumoenergy.com.au

18 November 2024

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

Dear Ms Elkins,

Re: Default market offer prices 2025–26: Issues paper

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to make this submission to the Australian Energy Regulator's (the AER's) issues paper for the Default Market Offer (DMO) for 2025–26.

We acknowledge the legitimate reasons for the AER prioritising the affordability element of the DMO policy framework relative to other policy objectives. Recent determinations have occurred at a time of significant cost of living pressures for many energy consumers. Governments have actively sought to alleviate this through Energy Bill Relief payments and other forms of assistance, such as concessions and emergency rebates. These co-exist with the extensive protections and support available to consumers experiencing payment difficulties. We are very mindful of our regulatory obligations to support these consumers and look forward to continuing to work with the AER as it progresses its *Review of Payment Difficulty Protections in the National Energy Customer Framework*. In our view, these targeted measures are the most effective ways to support energy consumers who are struggling to pay their bills.

However, we see some risks for the competitive market if the AER continues to balance the policy objectives as it did for its previous DMO determination. It remains our strong view that effective competition delivers significant benefits to all consumers. This is apparent not just in terms of pricing but also for other aspects of the retail service offering. This includes the development of products and services that provide greater visibility of and control over consumption decisions, offerings that maximise the value of consumer energy resources, and support for consumers as they navigate the energy transition.

Regulation should encourage consumers to participate in the market with confidence. This has been the focus of numerous regulatory initiatives in recent years, such as the *Better Bills Guideline* and the Consumer Data Right. Regulated pricing can complement this by providing confidence to market participants and potential entrants that they can invest and innovate, while recovering reasonable costs.

We strongly encourage the AER to continue to monitor market outcomes to assess the impact of its policy and methodological decisions. As an example, the decision to remove the competition allowance and the absence of clear criteria for its reinstatement, may discourage innovation and new entry. A reasonable competition allowance would also support the energy transition in the coming years. It allows retailers to directly invest in or enter into contracts with other forms of generation, particularly as coal fired generators look to exit the market.

The remainder of this submission focuses on specific issues raised in the AER's issues paper.

Solar exports and hedging costs

Prudent retailers hedge for their broader portfolio of customers and they simultaneously account for residential and small business customers' imports (consumption) and their solar output (exports), i.e. for their net position, rather than managing each in isolation and through different mechanisms. The increasing volume of solar is fundamentally altering the load shape that retailers must hedge and this is easily observed when comparing the difference between a profile that includes solar and one that does not. The AER now has another year of data that it can use to make this comparison. In short, solar adds to the cost of hedging and volatility by altering the peak to average load ratio.

The AER and its consultants note that retailers must account for the increasing incidence of periods where negative net load coincides with negative prices in the wholesale spot market. The AER suggests these periods are offset by those in which negative net load coincides with positive wholesale prices; this is one of the AER's key reasons for deciding not to account for exports in load profile. This may have been the case in the past but is unlikely to be the case into the future.

We note the significant increase in the amount of 5 minute dispatch intervals with a negative spot price in the NEM over the last three years (depicted in the chart below). We see this trend continuing and as a result, it is far more likely that retailers will be exposed to a negative price and a negative load rather than a negative load and a positive price.

	% of 5 minute settlement periods with negative price			
	NSW	***SA***	***Qld***	***Vic***
FY22	1.6	17.4	3.2	13.6
FY23	4.1	23.3	7.3	17.6
FY24	6.4	21.9	14.8	20.0

The increase in 5 minute dispatch intervals with negative spot prices is due to a combination of factors (noting it is more pronounced in some regions than others). These are the increased volume of solar output, bidding by grid scale renewable energy generators that qualify for Renewable Energy Certificates (RECs) at their REC price to ensure they are dispatched, and coal-fired power stations bidding their energy at significant negative prices to avoid expensive restarts.

We encourage the AER to account for the evolving nature of load profile; this means specifically accounting for the impact of solar exports and how they impact hedging strategies. This also means accounting for the cost of the products that retailers are using to manage their exposure. Lower feed-in tariffs are one mechanism (as the AER suggests) but this is only one element of a broader strategy to remain competitive in the retail market.

Other strategies to manage load involve revised contracts with generators but they are increasingly impacted by the prevalence of negative prices. Our confidential attachment to this submission provides more detail about how these costs are evolving and illustrates why retailers must consider other strategies. This might involve seeking to change the composition of their customer base, or investments in other forms of generation. The AER and its consultants are aware of this issue and should account for the changing nature of the market in the methodology to calculate wholesale costs.

System Load Profiles

The AER has proposed a number of options for developing an appropriate estimate of load profile for south east Queensland and SA. We acknowledge the AER's desire to maintain a consistent methodology for estimating different elements of the cost stack until it becomes clear through evidence that a change is warranted. In this case, however, the change is due to concerns about the validity of AEMO's adjustments to Net System Load Profile (NSLP) between October 2021 and October 2023. We agree it is reasonable for the AER to amend its method under these circumstances.

Red and Lumo's preference is for Option 2, that is, to use a blend of 1 or 2 years of NSLP data and interval data from the past two years. This will produce the most accurate and reasonable estimate of the market conditions that retailers are managing. This necessarily involves some reliance on adjusted data (about which the AER continues to have some concerns) but the blended approach overcomes some of these concerns and provides a more rigorous approach than was the case for DMO 6.

We also note the prohibition on the use of controlled load profile (CLP) for NSW, which took effect on 1 September 2024. As such, the energy previously captured and settled under the NSW CLPs is recorded and settled under the NSLP. This means that the CLP that AEMO has used in the past to forecast CLP won't be relevant for DMO 7.

Red and Lumo's preference for the CLP is Option 2. We acknowledge that control load profiles of the NSLP and CLP are all different across the distributors in NSW and so it is unlikely that this approach will specifically reflect the demand patterns of controlled load customers across every NSW distributor. Nevertheless, compared to the other options, Option 2 is likely to be the most accurate estimate of hedging controlled load demand.

In contrast, Option 1 does reflect the new approach for which retailers are likely to hedge for their controlled load customers in NSW as it uses a historical CLP to forecast the load shape in NSW. Furthermore, Option 3 would not include controlled load customers with an accumulation meter and is unlikely to reflect market conditions.

Competition allowance

The removal of the competition allowance is one of the notable outcomes of the AER's decision to prioritise the affordability policy objective above the recovery of reasonable costs, and the promotion of competition and innovation. Reinstatement would signal to a broader range of retailers that they can potentially earn a reasonable return on their operations and investments in the competitive market. On the other hand, uncertainty about when it might be reinstated has the opposite effect.

The AER's stated position is that it will exclude the allowance where the Consumer Price Index is 'materially' above the Reserve Bank of Australia's target band of inflation over a 'sustained' period of time. We would welcome more definitive guidance about what this means in practice. As a further point, excluding the competition allowance perpetuates the view that the DMO is an 'efficient' price similar to the Victorian Default Offer (which is not a price cap) rather than a common reference price and fallback option for a small proportion of disengaged consumers. This view is contrary to the initial policy rationale for the DMO and to its specific objectives. It may also discourage some consumers from participating in the competitive market.

Estimation of retail operating costs

An estimate of retail operating costs that reflects a broad range of retailers is consistent with DMO policy objectives. Therefore, we support the AER's decision to collect information from an expanded group of retailers than is currently the case. The current approach, which relies heavily on the Australian Competition and Consumer Commission's (ACCC's) monitoring function, may underrepresent the operating costs of smaller retailers. The proposed approach will produce a better estimate of the 'reasonable' costs of acquiring and serving residential and small business consumers.

We also recommend that the AER examine how retailers are classifying various operating costs and whether there is consistency across industry. Retailers have some discretion in this regard and our own analysis of public statements and statutory reporting reveal some notable differences in how retailers treat specific cost items.

The most notable examples we have observed (and that we would be happy to discuss with the AER in more detail) are:

- *Treatment of leases* - leasing expenses are not reported as operating costs following recent changes to accounting standards. However, these remain a cost of doing business and it is reasonable for them to be included in regulated allowances.
- *Acquisition costs* - inconsistent treatment of some items, including the exclusion of commissions from acquisition costs and allocation of sign-on credits to margin.
- *Shared costs and overheads* - differences in the treatment of key items, including the exclusion of significant licensing fees and other IT / SaaS costs, cybersecurity and other corporate overheads. We have also observed some shifting of significant cost items across different periods, which might lead to arbitrary and unwarranted movements in the regulated allowance if they are reported to the ACCC in the same way.

We expect that retailers also differ in how they report information to the ACCC. Therefore, we encourage the AER to assess whether it should be more prescriptive in how retailers report this information as it develops its own data request. This would overcome inconsistencies and ensure the DMO allowance reflects an appropriate estimate of the reasonable costs of a broad range of retailers.

Blending network tariffs

We support the AER's decision to develop a blended estimate of network costs that accounts for flat and Time of Use (ToU) network tariffs. This reflects the increasing volume of smart meters across NECF jurisdictions and the impact of the distribution networks' assignment policies, under which consumers are generally assigned to a default ToU tariff following meter exchange. As such, we would support the development of a blended network cost based on a customer weighted average between a flat and a ToU tariff in each distribution network.

The AER sees some challenges in estimating consumption profiles when ToU structures can shift across different determination periods. However, it can use the information from the pricing models in the distribution networks' pricing proposals.

A further factor for the AER to consider is the various consumer protections that the Australian Energy Market Commission is considering as part of the Accelerated Smart Meter Deployment. It proposes that retailers must obtain explicit informed consent before they adjust the structure of retail prices regardless of the underlying network tariff to which a consumer is assigned. Furthermore, State Governments have either enacted or are consulting on a requirement for retailers to offer a flat price to all customers that is independent of the underlying network tariff.

We acknowledge the reasons for these measures. Consumers should have visibility of their consumption profile so they can assess how they might respond to different pricing structures. However, this is not the case for network tariff reassignment, which generally occurs immediately after an event such as the installation of a smart meter. This means that in an increasing number of cases, retailers will be charging a flat rate (with a flat DMO as both a reference price and price cap) while facing an underlying ToU network charge; the signal to encourage a consumer to shift their usage away from peak periods is not passed through. It is reasonable for retailers to recover the actual network costs they are facing in these instances.

About Red and Lumo

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales, Queensland and South Australia and the ACT to over 1.4 million customers. Should you wish to discuss aspects or have any further enquiries regarding this submission, please call Con Noutso, Regulatory Manager, on 0481 013 988.

Yours sincerely

Geoff Hargreaves
Manager - Regulatory Affairs
Red Energy Pty Ltd
Lumo Energy (Australia) Pty Ltd