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Submitted via email to: **DMO@aer.gov.au**

RE: Default Market Offer 2025-26 (DMO 7)

About Shell Energy in Australia

Shell Energy delivers business energy solutions and innovation across a portfolio of electricity, gas, environmental products and energy productivity for commercial and industrial customers, while our residential energy retailing business Powershop, acquired in 2022, serves households and small business customers in Australia.

As one of the largest electricity providers to commercial and industrial businesses in Australia[1], Shell Energy offers integrated solutions and market-leading[2] customer satisfaction, built on industry expertise and personalised service. Our generation assets include 662 megawatts of gas-fired peaking power stations in Western Australia and Queensland, to provide back-up for rising levels of renewable energy, and the 120-megawatt Gangarri solar energy development in Queensland. Shell Energy also operates the 60MW Riverina Storage System 1 in NSW.

Shell Energy Australia Pty Ltd and its subsidiaries trade as Shell Energy, while Powershop Australia Pty Ltd trades as Powershop. Further information about Shell Energy and our operations can be found on our website here.

General Comments

Shell Energy welcomes the opportunity to provide feedback to the Australian Energy Regulator (AER) consultation on the Default Market Offer 2025-26 (DMO 7).

We appreciate the consultation opportunities the AER has created as part of this process, including individual meetings and workshops with a range of retailers to understand the issues faced in applying the DMO.

A common thread throughout the consultation process has been a renewed focus on consistency. We are encouraged by the AER seeking a consistent approach for the DMO moving forward, as we have raised previous concerns on the departure from the initial intent and key objectives. We consider that stepping away from these guiding principles has had an impact on the retail market, largely due to the recent decision by the AER to exclude the competition allowance from the calculation.

The energy industry is navigating a complex period of transition where key infrastructure and technologies are being updated and implemented at a rapid pace and AEMO processes and methodologies are being updated to reflect these changes.

At a time of such rapid change, the best approach to setting the DMO is establishing a consistent set of principles that allow the underlying calculations to reflect a dynamic market and enable the DMO to take into account changes as they occur. While we are highly supportive of the AER returning to the original intent and

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objectives of the DMO, we consider that in this phase of the transition, it would be premature to commit to a rigid formula in calculating the DMO due to the constant shifts in core market dynamics such as rules, processes, and procedures. For instance, recent changes include the accelerated roll out of smart meters as driven by the recent AEMC Smart Meter Review, uptake of household solar, and a greater reliance on variable renewable generation that has curbed traditional levels of supply and resulted in a push to shift consumer demand away from peak periods.

While the wholesale market continues to rapidly transition, the DMO's objectives should remain unchanged from its inception, that is it should be used:

1. As a safety net for customers that do not engage in market contracts to ensure that they are not subject to unjustifiably high prices; and
2. To increase transparency in the retail electricity market to allow consumers to easily compare offers and remove the confusion arising from pricing practices including discounts.

Indeed, these two objectives were noted in the Regulation impact statement for the introduction of a DMO price cap and reference bill on retail electricity prices.[1]

Recently the DMO has been flagged as an instrument to drive lower price outcomes across the market, including in market offers, which is at odds with its original intent of setting a default price for customers who are not engaged with the market. This has been noted by the AER previously, in that the AER: [2]

> *"...had regard to the need to reduce the unjustifiably high level of standing offer prices for consumers who are not engaged in the market. This is the key reason for the introduction of a DMO."*

And further noting that

> *"The ACCC stated the default offer should not exist to be the lowest price, or close to the lowest price in the market. Its purpose is to act as a fall-back position for those not engaged in the market or for those that require its additional protections. We consider that these factors are important in facilitating competition, efficient investment, and innovation in retail markets."*

Shell Energy considers the AER should return to the key guiding principles in determining the DMO. That is, ensuring the DMO is reflective of the underlying wholesale cost of energy, distribution, and transmission costs, providing for an allowance for retailer's costs and a reasonable margin, and maintaining competition in the market. In particular, we consider enabling and maintaining competition within the DMO is imperative when seeking to keep long-term costs to consumers down across the market.

Net System Load Profile and interval meter data

Shell Energy supports Option 1 in using two years of interval meter data only to simulate the load profile rather than blending with NSLP data. We consider that this option is more likely to provide the most accurate profile for a typical retailer and would assist in establishing a consistent approach in future years as the smart meter rollout ramps up and more of this data becomes available. This will also future proof the calculations going forward as the underlying methodology will not be subject to changes in the same way that the NSLP has been altered previously.

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[1] Regulation impact statement – the introduction of a Default Market Offer (DMO) price cap and reference bill on retail electricity prices page 13; see https://oia.pmc.gov.au/sites/default/files/posts/2019/04/2_regulatory_impact_assessment_-_default_offer_by_retail_code.pdf

[2] Draft Determination Default Market Offer Price, AER, Feb 2019 , page 8

To further improve the accuracy of the use of interval meter data, the AER could estimate the number of interval meters and basic meters per region and load weight the two accordingly. As more information becomes available, we also recommend the AER utilising this dataset to estimate future metering costs for retailers, which could include factoring the planned smart meter roll out into the DMO calculations. This would be a more accurate approach in developing the profile shape, which would better enable assessment of the wholesale hedging estimates and consequent pass-through component of a customer's bill.

Shell Energy would also support the AER establishing separate load profiles and associated wholesale cost forecasts for residential and small business customers. Further, Shell Energy would support public availability of the metering data used in the modelling to enable greater transparency.

Controlled Load Profile (NSW)

Shell Energy considers that Option 2 in blending historical controlled load data with the NSLP would provide the most accurate view until the scenario contemplated in Option 3 becomes a reality. We consider that Option 2 would essentially provide an interim measure until smart meter data is able to assist these calculations to a fuller extent.

We do not support Option 1 being adopted as historical load would not provide the current scenarios which retailers are hedging for. However, another option to consider in using this data could be to map the historical CLP against total system demand and adjusting the CLP year as the relationship changes due to customers moving away from consumption in the CLP window.

Solar PV exports and hedging costs

Solar cannot continue to be excluded from the DMO. Australia is a global leader in the uptake of rooftop solar, with at least one third of detached homes having rooftop solar installed, and AEMO projecting that this will rise to more than half of detached homes in the NEM by 2034[3]. In the first three quarters of 2024 alone, rooftop solar installation for homes and businesses added 2.03 GW of capacity from 214,813 photovoltaic (PV) systems, with a projected final number reaching approximately 249,000 installations which could contribute 2.37 GW in total capacity.[4] The AER's 2024 State of the Energy Market Report says:[5]

> *In 2023–24, output from rooftop solar increased by 16% compared with the previous year, and total output has more than tripled since 2017–18. In 2023–24 it accounted for over 11% of total generation, up from 10% the previous year. The rapid uptake of rooftop solar has dramatically changed the shape of daily spot price and grid demand in the NEM. Prior to mass adoption of the technology, the middle of the day typically saw the peak of both prices and demand in summer months; the opposite is now true.*

Rooftop solar has a direct impact on load profile estimation and forecasting, and therefore retailers hedging strategies. Indeed, solar exports are making hedging more costly and challenging. Many retailers will hedge at a portfolio level, which includes solar (consumption net of exports), however the DMO, as the price setting mechanism, does not consider this. By excluding solar, the AER is overlooking the higher hedging costs imposed on retailers.

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[3] *Integrated System Plan for the National Electricity Market – A roadmap for the energy transition* AEMO [2024] pg. 50. Accessed via: 2024-integrated-system-plan-isp.pdf

[4] *Solar Report – Quarter 3* Australian Energy Council [2024], pg. 3. Accessed via: australian-energy-council-solar-report-q3-2024.pdf

[5] *State of the Energy Market* AER [2024], pg. 51. Accessed via: State of the energy market 2024

Including solar within the DMO wholesale methodology is the best way to account for accuracy around wholesale costs given the high levels of solar PV amongst residential customers.

Further, we consider that there is a firm difference between feed-in tariffs and retail hedging strategies. Feed-in tariffs should not be assumed to reduce the risk around export and used to discount the need for solar export to be recognised in the DMO calculations as retailers do not separate hedging in this manner – this is neither representative of a typical retailer, nor is it an avoidable cost that retailers can carve out of their profiles.

The AER will need to contemplate how to include solar exports within the DMO in the future if it is not included within DMO 7. If retailers cannot pass through the costs of solar exports, it will eventually need to be built into pricing structures. We would encourage the AER to mitigate risks relating to a lack of incentives for retailers to actively engage with potential solar customers and reducing perceived cross-subsidisation between different customer segments.

Finally, future DMOs will need to consider solar export tariffs imposed by distributors, and how this is to be passed through to the customer.

SA Wholesale methodology

Gathering additional information for confidential over-the-counter (OTC) contract data would impose unnecessary burden on participants where for the two previous DMOs, the "OTC data provided to the AER suggested that relevant OTC trades are broadly consistent with [publicly available] ASX traded contract prices and volumes".[6]

While we understand the importance of the AER investigating contract market liquidity in South Australia, there are dedicated teams within the AER that are empowered to perform this function. We therefore consider it unnecessary to seek this information under the DMO when it is already being executed and performed under the Wholesale Market Monitoring functions of the AER, particularly where the information collected previously has been aligned with publicly available data.

In relation to the Long Run Marginal Cost (LRMC), we would be supportive of this analysis being repeated so long as it is based on generation that can provide effective risk management for a residential retailer (i.e. GPG or a portfolio comprising of wind, solar and BESS), at a significant scale to manage the highest 10% of demand days coupled with the lowest 10% of wind days.

Inputs into wholesale modelling

As per our previous DMO submissions, Shell Energy maintains that the Retailer Reliability Obligation (RRO) should be a consideration when determining the wholesale cost component. While the three forecast reliability gaps for 2025-26 have now been revoked, future reliability gaps for 2026-27 in Victoria, NSW and South Australia should be considered in future DMO processes.

In our experience, the RRO essentially adds a premium to operating within the identified regions as retailers effectively need to over hedge their positions to account for the reliability gap and mitigate compliance risks. This becomes difficult in regions such as South Australia where there is already limited liquidity. We argue that retailers may typically hold higher contracting cover during RRO gap periods and that these contracts are bought earlier than they generally would. Based on the experience in South Australia in Q1 2024, This should be reflected in the way the DMO is set in the event of a T-1 gap period being in place.

Shell Energy urges the AER to contemplate the impact the RRO will have on retailers operating within regions with a forecast reliability gap, and how this will impact the wholesale component on the DMO. Due to the lack of liquidity and depth in these markets (worsened by RRO events) retailers tend to 'over-contract' by purchasing

[6] *Default market offer prices 2025-26 Issues Paper* AER [October 2024], pg. 22.

cover surplus to requirements, driving higher contract prices. While the Market Liquidity Obligation (MLO) provides additional liquidity, this tends to be for annual contracts, rather than just the quarter a gap period is in place. This results in retailers effectively needing to contract at higher levels all year round, to manage a compliance risk that exists in just one quarter. The changing nature of liquidity in contract markets and the limitations of the MLO market, is a cost of system reliability and must be recognised in the DMO.

Retail costs

Collecting data from a representative sample of 25 retailers, as opposed to just the Tier 1s, would support greater accuracy in determining the retail cost stack, particularly as this relates to costs to serve, as well as acquire and retain customers.

The information provided to the AER would also be more insightful if participants were clear on what outcome the data would serve. We recommend the AER is clearer on how it will use the data collected ahead of information requests being distributed so that participants can better assist the AER in the information provided.

Shell Energy supports including the cost of the AEMC Smart Meter Rollout in the retail cost stack. Following the recent rule change by the AEMC, the cost of installing smart meters is set to increase significantly over the coming years to achieve the goal of 100% uptake among small customers by 2030. This is expected to be a significant component of retailer costs as the industry and participants make the steep climb from current levels of smart meter penetration to the targeted ones.

Shell Energy considers that the RRO should also be considered under retail costs as there is a material cost and compliance gap that could expose retailers to risk under a declared RRO. Given that there are two forecasted gaps set to occur in DMO regions over the life of DMO 7, we consider that the costs retailers will be subject to in serving and maintaining customers during these periods should also be accounted. The costs of complying with declared RROs are incurred by retailers and should be included as a cost component of the retail price for electricity.

We also consider that the seven rule change requests which the Chair of the Energy and Climate Change Ministerial Council (ECMC) has submitted to the AEMC will become a component of retail costs once they are implemented. While noting that there is not currently a committed timeline associated with the rule change requests, it is apparent that jurisdictions are moving ahead to implement these ahead of a NEM-wide decision which will impact retail compliance costs. For instance, the New South Wales Government and Essential Services Commission Victoria (ESCV) are currently contemplating improving the application of concessions to bills, and the ESCV is also considering improving the ability to switch to a best offer.

It will be challenging for smaller retailers to adapt to these changes as they have limited ability to mitigate risk where there is a misalignment between state and federal policy, making it more difficult to remain competitive in the market against larger retailers who can absorb risk and associated costs. These impact of these changes at both the jurisdictional and NEM-wide level will be incurred over the DMO 7 period.

Competition allowance

Shell Energy does not support the exclusion of the competition allowance from the DMO. The approach adopted for DMO 6 appears to be contrary to the policy objectives that have underpinned the DMO from its inception and appears to be a change in direction by the AER in no longer recognising the critical nature of innovation, investment, and customer engagement in the market. Indeed, at its inception, the DMO's Regulatory Impact Statement noted that "stakeholders identified a risk that the DMO and reference price are set at levels below the efficient cost of providing electricity", however the Statement noted that this "is against the intent of

the policy, which is to provide a safety net for consumers, but still allow retailers to compete."[7] It is an important reminder of the policy intent that the DMO should not undermine the competitive market.

It is also noted that, the AER has previously considered this intent: [8]

> *"In recommending a DMO, the ACCC was explicit in its intention that the DMO price should be set at a level that allowed retailers to recover the efficient costs of servicing customers in each distribution zone, including costs for acquiring and retaining customers."*

While we support the AER implementing mechanisms to relieve cost of living pressures for consumers, the DMO is not the appropriate instrument for addressing this. Government initiatives such as concessions and energy bill relief have proven as effective tools which can provide both short and longer-term relief to consumers. Retailers also have policies and processes in place to assist those consumers facing payment difficulties, and there is other support offered by the energy sector and more broadly to address cost of living pressure.

Competition within the retail electricity market puts downward pressure on prices, through development of new and innovative market products, providing consumers with better service and assistance, and supporting the evolving needs of consumers as patterns of electricity generation and usage evolve. Indeed, the AER acknowledges that:[9]

> *Competition in retail energy markets is necessary to stimulate innovation and ensure better quality, lower cost products and services for consumers. The AER's role in delivering consumer protections – such as monitoring and reporting on market performance, enforcement and compliance activities, provision of price comparison services, setting the default market offer reference price and regulating monopoly infrastructure – must be balanced to ensure market competition isn't unnecessarily hindered.*

The ACCC's submission to the DMO 6 Draft Determination is also aligned with this view, highlighting the implications of changing the calculation of the retail allowance:[10]

> *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.*

The competition allowance should not be subject to any form of 'trigger' and instead be always included in the DMO price calculation to protect the competitive retail market and long-term consumer interests.

Shell Energy understands that the AER intends to link the reinstatement of the competition allowance to 12-month movements in the Consumer Price Index (CPI), specifically where CPI is materially above the Reserve Bank of Australia's (RBA) target band of 2 to 3% for a sustained period.

The RBA inflation target is used for setting monetary policy. It is misplaced to use this a trigger for the electricity retail market competition allowance as it introduces uncertainty, on a timescale detached from retailer decisions around investment and innovation. At times of high inflation and therefore cost of living pressures, competition should be supported to drive lower price outcomes for customers. We are concerned that the approach

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[7] Regulation impact statement – the introduction of a Default Market Offer (DMO) price cap and reference bill on retail electricity prices page 31

[8] Default Market Offer Price Draft Determination, AER Feb 2019 page 33

[9] *State of the Energy Market* AER [2024], pg. 273. Accessed via: State of the energy market 2024

[10] ACCC Submission to the DMO 6 Draft Determination [9 April 2024]. Accessed via: ACCC - Submission - DMO 6 draft determination - 9 April 2024

proposed by the AER adopts a short-term lens at the risk of distorting the level of competition in the longer term. Indeed, this is contrary to the overall goal of lowering the cost of electricity for consumers, as well as a further step away from the original intention of the DMO in creating a safety net for disengaged customers. Any short-term relief gained from excluding the competition allowance will likely to be at the cost of long-term investment in the market.

Using the RBA's inflation target also suggests that retailers and prospective market entrants need to forecast expected persistent or sustained inflation before investing whereas such decisions have much longer investment horizons.

Other DMO costs and considerations

Environmental Costs

Shell Energy supports the DMO being inclusive of environmental schemes as the costs are incurred by retailers and are therefore appropriately included as a component of retail cost calculations. We support the AER retaining a market-based approach to environmental cost estimations provided these are reflective of actual market costs.

Flat and Time of Use Tariffs

Shell Energy supports the AER in maintaining the status quo in relation to the application of a flat tariff to small business customers. We consider that the current legislation only requires the flat tariff to apply to this customer cohort, and this remains appropriate. There is also a separate DMO for small businesses which distinguishes these customers from mass market customers, and the issues specific to that cohort.

In relation to whether to blend flat rate and time-of-use (TOU) network tariffs, Shell Energy supports blending these profiles and establishing a weighted average of flat and TOU residential customers to calculate the network costs. We consider that this approach is more reflective of the current market as more customers are put on TOU tariffs as the smart meter roll out continues.

While we support blending flat and TOU tariffs for the DMO, we are concerned that the AEMC's Smart Meter Acceleration – Customer Safeguards draft rule change currently allows for a mismatch of retail and network tariffs as the Explicit Informed Consent (EIC) Period will not allow for retailers to shift customers onto a TOU tariff after a smart meter has been installed, while the networks are not subject to the same requirement.

This means that where a network tariff changes and the retail tariff cannot be aligned, retailers may not be able to recover the cost of this mismatch. Where EIC is not given, retailers cannot move the customer to a different tariff for three years, while the charges from networks will remain based on the TOU tariff. The inability to align retail tariffs to the assigned network tariff creates a mismatch where retailers are unable to recover their costs over an extended duration of time.

Retailers, with limited influence over the structure or cost of monopoly network company tariff settings, cannot mitigate or hedge the largest component of the retail tariff. The impact of this misalignment can be significant, particularly for small and medium retailers, who will be impacted in their ability to remain competitive amongst larger retailers who are able to recoup their costs from a larger cohort of customers. Ultimately, this will further reduce competition in the market, which will have a negative impact on consumers.

In a study of the impact of network tariff reform on retail offers (2020-25) where South Australia and Queensland distributors had proposed the movement to new time-based price signalling (non-flat tariffs) with the installation of smart meters; the AER found:[11]

> *...the underlying network tariff structure that distributors will charge retailers for customers who have a smart meter will be changing. For all customers with a smart meter, the retailer will be charged a network tariff that has a time-based price signal – to encourage greater use of the network during off-peak times and to encourage less use of the network during peak times. The retailer will be charged either a time-of-use energy network tariff or a peak demand-based network tariff.*

Further, in the final determination by the AEMC on the Network Pricing Arrangements rule change in 2014, it was also stated that:[12]

> *Retailers operate in a competitive market and outcomes for consumers will be improved if retailers are free to design their prices as they see fit in response to consumer preferences and the other costs retailers face. However, because network charges are retailers' largest cost, they will have a significant incentive to pass on network price signals to consumers in some form when deciding how to structure their retail prices.*

Both the AER and AEMC acknowledge above that network tariff structure has a direct effect on consumer pricing and that the move to cost-reflective network tariffs has been supported by networks and policy makers to drive changes in customer usage behaviour, with the understanding that the network tariff costs and pricing signals flow through to customers. They also demonstrate an understanding by the market bodies that retailers must front the cost from distributors before it is passed onto the consumers.

Under the proposed safeguards, retailers will not only be expected to front this cost but also absorb it where there is a mismatch between what a distributor charges a retailer, and what a retailer can charge a customer. The impact of this on retailers is compounded in a mass rollout of smart meters if consent to change the tariffs is not given by customers. While industry awaits the final decision from the AEMC, the impacts of the final decision are likely to be felt by retailers during the DMO 7 period. As such, we encourage the AER to monitor the final decision and model the impact of the decision on retail costs, as they pertain to the smart meter rollout and the mismatch in retail and network tariffs.

In relating this back to the specific question raised, Shell Energy considers that a weighted average of blended flat and TOU tariffs would be more cost-reflective of current circumstances and will enable the AER to address historical inaccuracies. However, the AER must also be alive to the potential that that network tariffs will not necessarily represent the full extent of retail costs if the AEMC rule change proceeds as drafted. The recent determination in Queensland is a prime example of this where retailers must offer a flat standing tariff regardless of the underlying network tariff. The DMO must allow retailers to recoup sufficient network costs in light of emerging mismatches.

Shell Energy welcomes further engagement on this topic. If you have any questions or would like further information relating to this submission, please contact Shelby Macfarlane-Hill at Shelby.macfarlanehill@shellenergy.com.au.

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[11] *Understanding the impact of network tariff reform on retail offers* Australian Energy Regulator [2020], accessed via https://www.aer.gov.au/system/files/Understanding%20the%20impact%20of%20network%20tariff%20reform%20on%20retailers%20in%20SA%20and%20QLD.pdf

[12] *Distribution Network Pricing Arrangements, Rule Determination* AEMC [2014], accessed via https://www.aemc.gov.au/sites/default/files/content/de5cc69f-e850-48e0-9277-b3db79dd25c8/Final-determination.PDF

Yours sincerely

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