



Default Market Offer

Options Paper on the methodology to be adopted for 2022-23 and subsequent years

Presentation to AER stakeholder forum

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10 November 2021

To submit questions:

<https://www.sli.do>

Code: DMO4PUBLIC

aer.gov.au

DMO methodology review - rationale

- After 3 years, ensure our approach and assumptions remain appropriate to meet the policy objectives
 - Prevent high standing offer prices
 - Retailers can recover costs, plus a reasonable margin
 - Incentives for competition, innovation, investment and market participation

Overarching approach: indexation vs cost build up

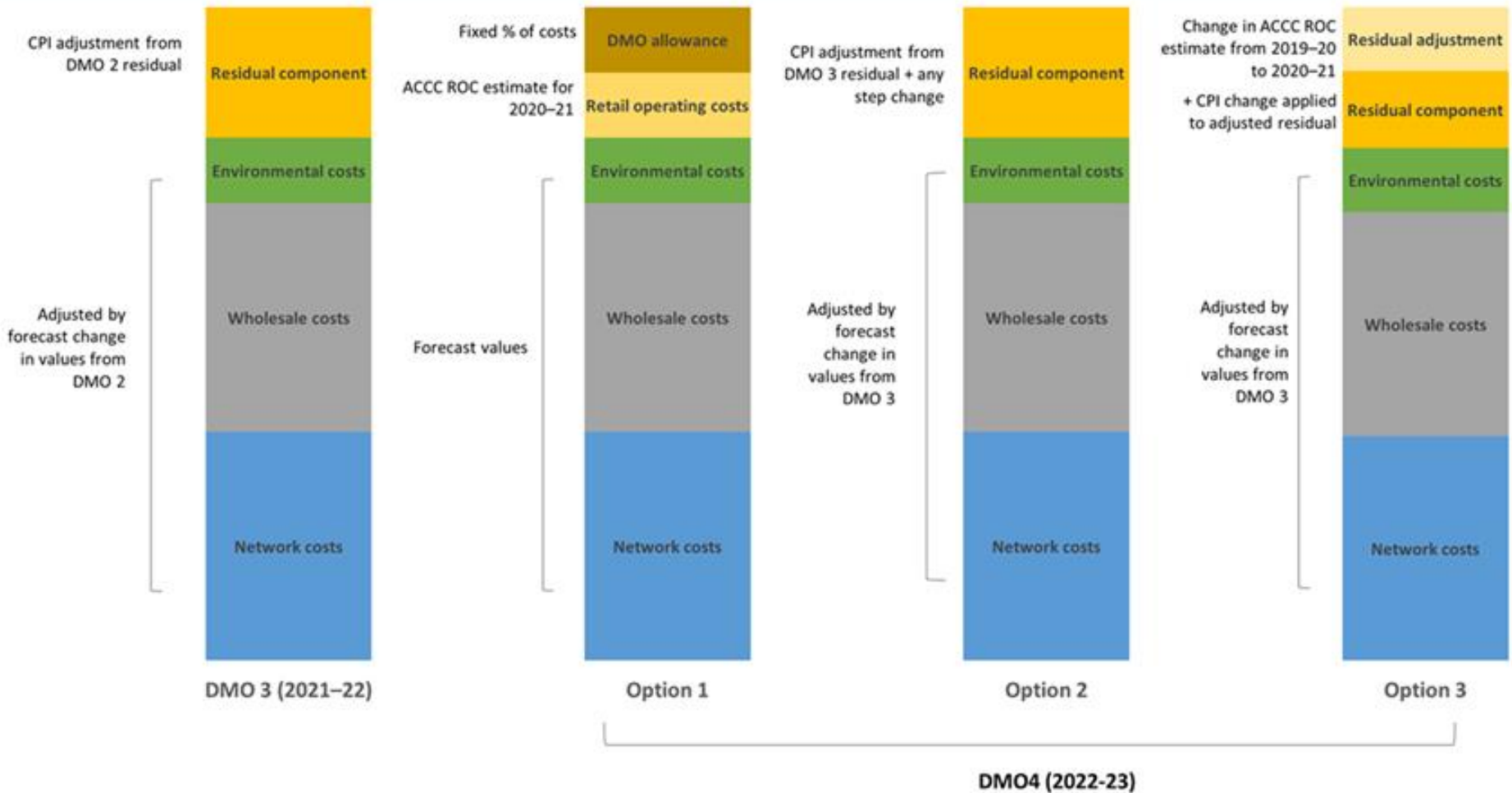
Cost build-up

- DMO price built up from forecast costs of each cost stack component, including retail costs & margin
- Proposed approach if we adopt retail option 1

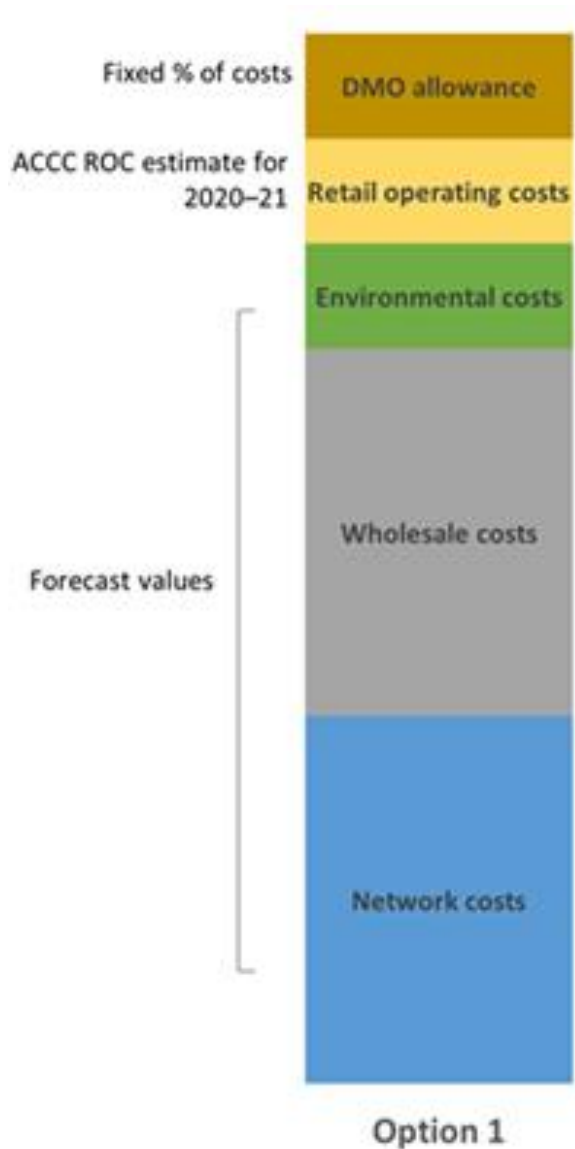
Continue indexation

- Annual adjustment based on how cost stack elements are expected to change, including retaining the retail 'residual'
- Proposed approach if we adopt retail option 2 or 3

DMO 4 – Overarching approach options



Option 1 - cost build-up



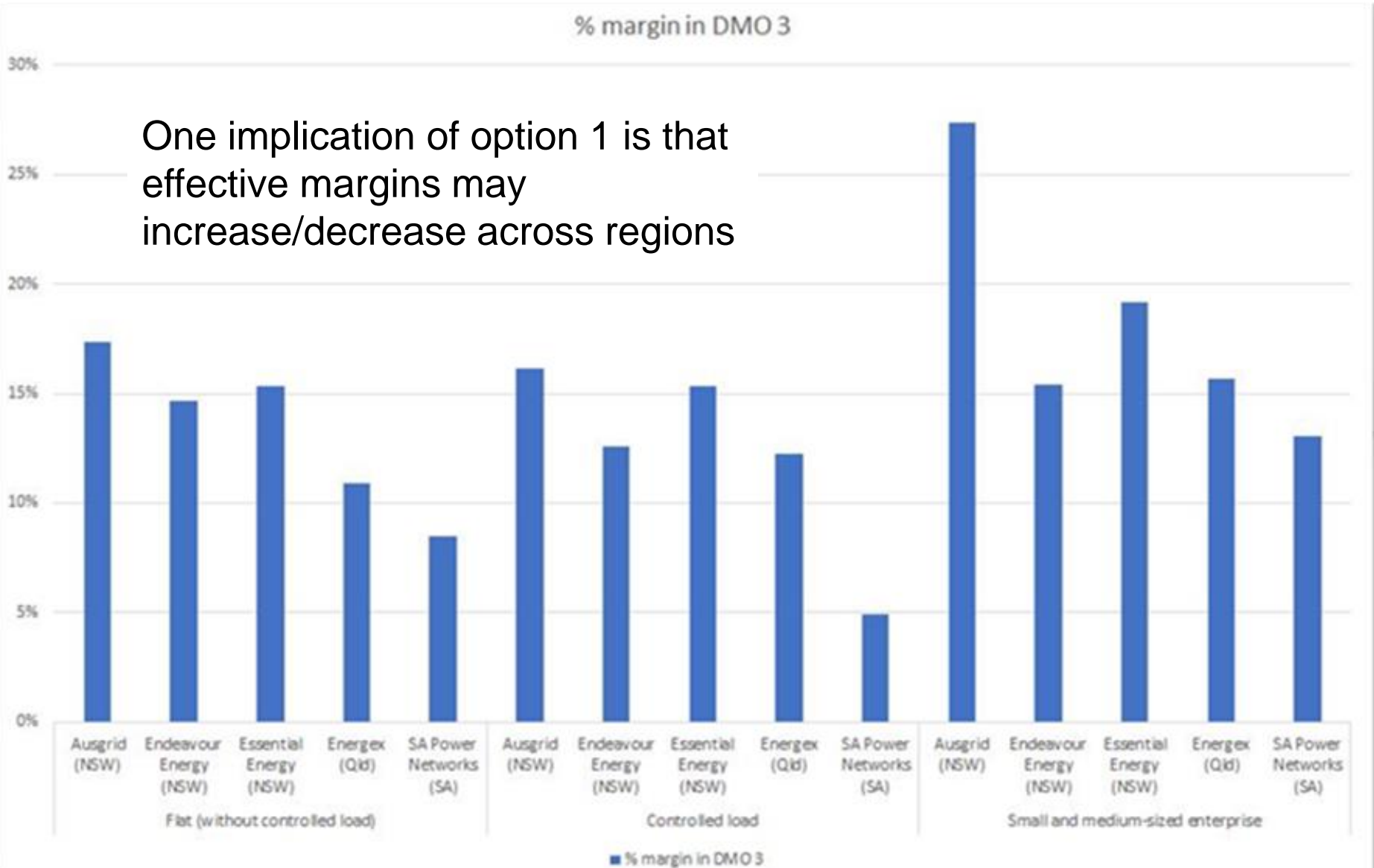
- AER would determine a retail margin plus an additional allowance to meet the DMO objectives
- Unlike the current residual, these would be specified as cost stack components, and be transparent to the market

Key questions:

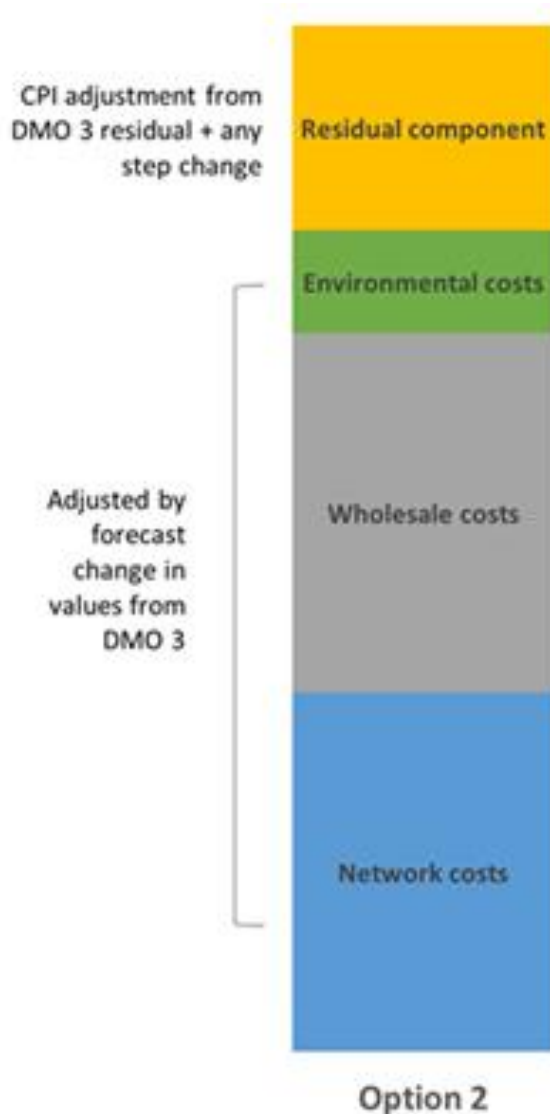
- What is a reasonable profit margin?
- What additional allowance meets the objectives?

Nominal margin available in DMO 3

One implication of option 1 is that effective margins may increase/decrease across regions

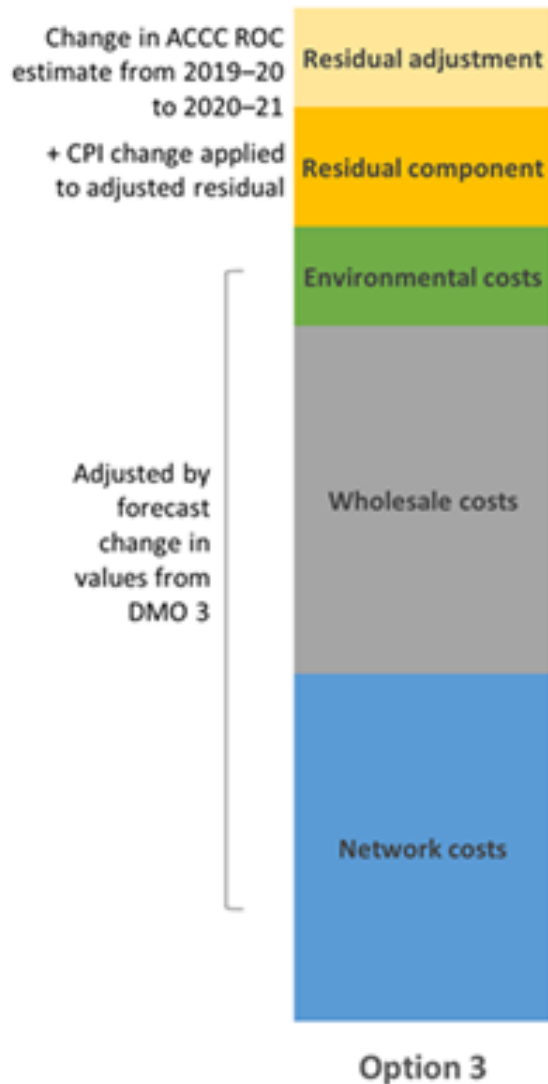


Option 2 - continue indexation



- Builds on earlier versions of the DMO
- Accepts status quo for retail costs & margin
- Margins continue to vary across regions
- The DMO 1 price was set using market offers from October 2018 and the variance in residual reflects the market conditions at that time. These market conditions may no longer be relevant

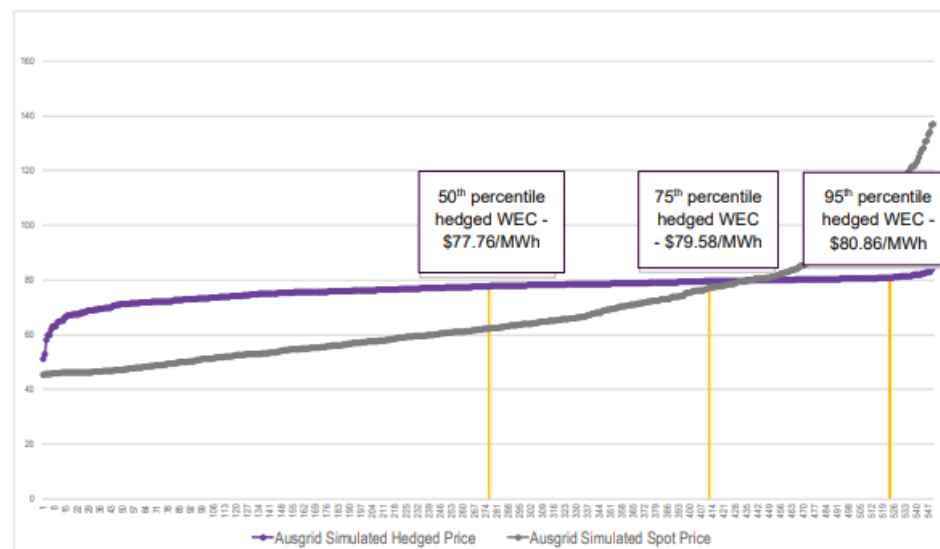
Option 3 - residual ROC adjustment



- ACCC data enables transparent annual adjustment to the residual
- Ensures the additional allowance remains closely aligned with the DMO 1 from year to year
- Does not address the differences between regions and customer types that result from 2018 market conditions
- Retailers face a delay to ‘catch up’ costs

Wholesale forecast settings

- Seeking views on whether some key variables that influence on our forecasts continue to meet the DMO objectives and stakeholder expectations
 - assumed hedging strategy of our ‘representative retailer’
 - the error margin in our forecasts



DMO 3 – WEC \$ variance at different points in range of modelled outcomes

Other issues for the review

Annual usage benchmarks

- Residential – retain or update benchmarks?
- Small business – adopt lower benchmark?

Other issues

- Advanced meter costs – reflect in DMO price?
- Duration of methodology – 3 or 5 years?
- Incorporating approved network prices – DISER review

Next steps

19 November 2021
Options Paper
consultation closes

April-May* 2022
Final DMO 4
Determination
released (*subject
to DISER's review)

February 2022
Draft Determination
released for
consultation

Craig Memery

Public Interest Advocacy Centre

Default Market Offer AER Options Paper

10 November 2021



Overall approach

- All proposed AER DMO methodologies are workable:
 - Challenges lie in the detail
 - Important that the underlying cost is recovered
 - No correct answer – history of price regulation
- Any change from current methodology introduces significant regulatory risk
 - Potential impacts on market competition, financial viability and investment
- Policy objectives were to:
 - 1) ensure standing offer prices were not inflated, and
 - 2) provide a reference price to improve transparency/clarity for customers
- DMO has met Government's policy objectives
 - Need a good case for change

Implications of Bottom-up approach

Positives

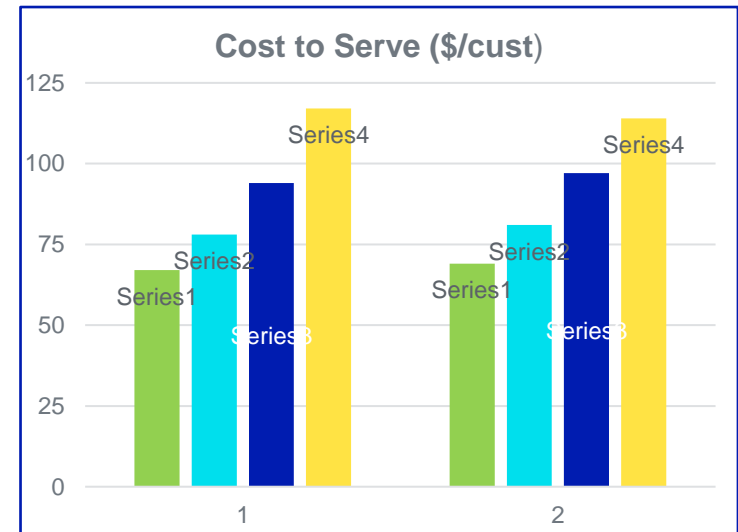
- Transparent
- Rebalances the “nominal margin” component in South Australia
- Allows AER to more easily incorporate additional cost elements
- Can be more reflective of changes in retail costs

Cons

- Need greater focus on the AER’s modelling outcomes
 - Do the level of estimates for wholesale, environmental schemes etc. reflect underlying cost?
- Required to explicitly estimate:
 - Retail Operating Cost
 - Retail Margin
 - What allowance is needed for competition and why

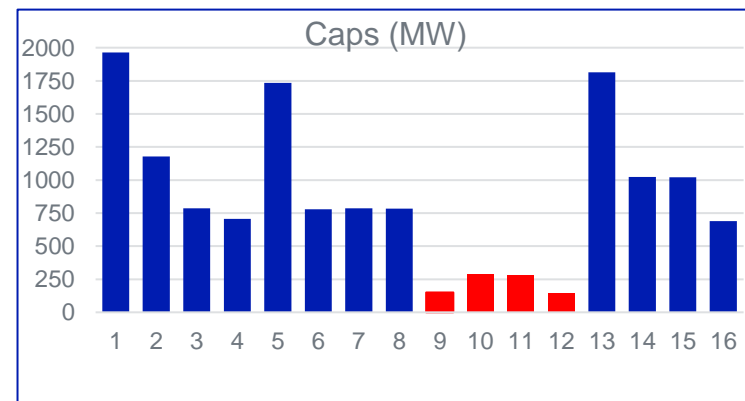
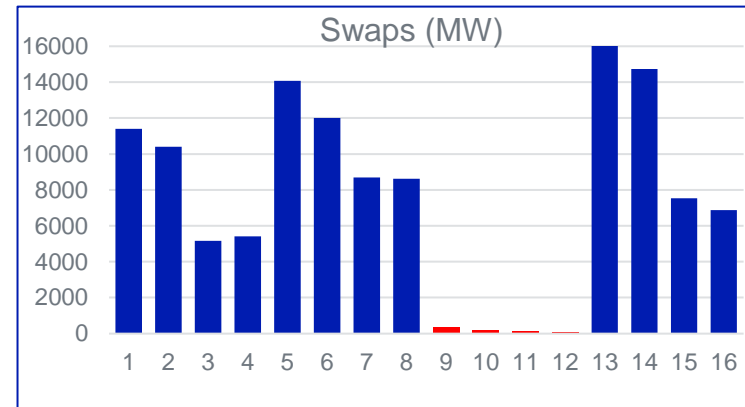
Retail Cost Data

- Concerns with determining the level of retail operating cost using ACCC cost data.
 - Cost to serve – retail operating costs
 - Corporate overheads/ depreciation / amortisation
 - Excludes bad debts?
- What is an average retailer (e.g. scale, type)
- How would AER select the representative retailer?



Indexation Method Issues

- Consistent residual – one-off adjustment
- Residual component could consider changes in retail cost data, rather than just CPI.
- How the AER introduces new cost elements under the indexation approach (e.g. AEMO directions)
- South Australia wholesale electricity cost
 - No liquidity
 - Infrequent trades
 - Small volumes compared with other states
 - Forward market does not reflect supply cost, impacting modelling





Australian Government

Department of Industry, Science,
Energy and Resources

Default Market Offer and Reference Price

Review of the *Competition and Consumer (Industry Code – Electricity Retail) Regulations 2019*

Australian Energy Regulator DMO 4 review – DISER DMO Review update
November 11

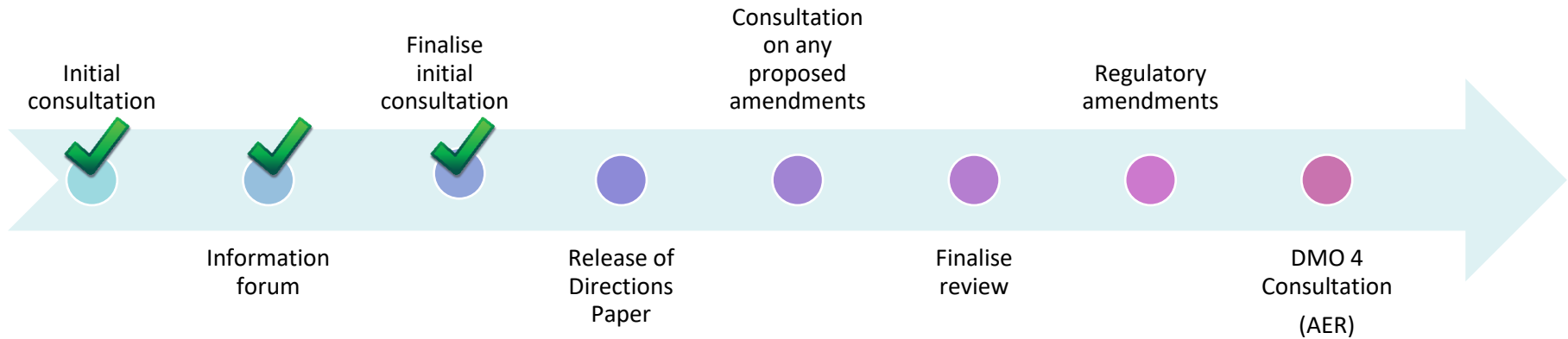
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Structure of the DISER DMO review

- Consumer outcomes
 - Awareness and use
- Impacts on Pricing
 - Changes to standing offers, market offers and conditional discounting
- Operation of the code
 - Coverage of the code and its application – not how the DMO is set



DISER DMO Review timeline



Results from initial consultation



- 17 submissions received
- Policy intent recognised:
 - capping high price standing offers; and
 - establishing simple price comparisons.
- Common concerns raised:
 - Reference price comparisons – challenging for non-standard offers
 - Determination timing – not well aligned with other important determinations

Next steps



- A directions paper is being prepared, which will:
 - detail feedback received
 - propose how to address concerns; and
 - how to improve the operation of the Code
- Consultation on the directions paper will be made available through the DISER Hub at
- <https://consult.industry.gov.au/energy/review-of-default-market-offer-and-reference-price>
- Any questions, please email electricitycode@industry.gov.au

Thank you

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Short break – to submit questions

- We'll reconvene in 10 minutes for Q & A
- Please submit questions via Sli.do
 - Go to: **www.sli.do**
 - Sli.do code: **DMO4PUBLIC**

Questions

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