ActewAGL

Mr Mark Feather
General Manager
Policy and Performance
Australian Energy Regulator
GPO Box 520
Melbourne, Vic, 3001

18 November 2020

Dear Mr Feather

Position Paper - Default Market Offer Prices 2021–22

ActewAGL welcomes the opportunity to respond to the Australian Energy Regulator's (AER's) Position Paper on Default Market Offer Prices for 2021–22.

ActewAGL has prepared responses to each of the questions raised by the AER in the Position Paper.

If you wish to discuss any aspect of ActewAGL's submission, please contact Kate Goatley on (02) 6175 2445.

Yours sincerely

Kate Dean
Acting General Manager Retail

1. **Do you agree with the principle that forecasts and assumptions from previous DMO determinations should not be retrospectively amended to reflect actual information?**

   ActewAGL agrees that forecasts and assumptions from previous determinations should not be retrospectively amended to reflect actual information. The DMO is intended to be a forward-looking instrument, facilitating the comparison of offers from different retailers by consumers. The DMO is not intended to be an estimate of efficient costs, unlike the regulation of electricity prices in Victoria and the ACT.

   To determine a reference price that facilitates competition, and allows retailers to recover costs and a margin, the AER should use the most accurate information available at the time of the final decision.

   In some instances, the current requirement to publish a final decision by 1 May (two months before coming into effect) does not allow sufficient time to set reference prices based on accurate or final cost information. In comparison, the Victorian Essential Services Commission (ESC) and the Independent Competition and Regulatory Commission (ICRC) in the ACT publish final decisions on retail electricity prices approximately one month before coming into effect.

   The AER should consider an amendment to change the DMO determination date to allow for the final decision to be handed down later than 1 May. This would provide additional time for final cost information to be used.

2. **Does our assumption of a risk averse retailer building their hedge book from the time of the first trade recorded by ASX Energy remain appropriate, or is a shorter period justified? What is an appropriate period and why?**

   ActewAGL proposes a shorter, 24-month timeframe as 98% of ASX trading typically occurs within the final 24 months. The ICRC currently use a 23-month timeframe as part of its regulation of ACT standing offer electricity prices.

3. **Does the Consultant's 95th percentile estimate remain appropriate, given the hedging strategy? What alternative percentile could be applied and what would the justification be?**

   ActewAGL supports the use of the 95th percentile estimate. The 95th percentile is also used by the ICRC as part of its regulation of ACT standing offer electricity prices.

4. **Do you agree with our proposed approach to assign ancillary service charges to each state, rather than smeared across the DMO jurisdictions?**

   ActewAGL supports the AER's proposed approach to assign the costs of ancillary services at a jurisdictional level, rather than smeared across the DMO jurisdictions. This proposed approach would more closely reflect the ancillary service charges incurred by retailers.

5. What are the implications of differentiating between residential and small business load profiles to forecast wholesale costs?

ActewAGL supports the current methodology to forecast wholesale costs, rather than the proposal put forward by the AER in the Position Paper. ActewAGL is of the view that the current methodology (combining wholesale costs for residential and small business customers) is a reasonable method, which achieves the aim of the DMO to:

1. Reduce unjustifiably high standing offer prices, and
2. Provide a consistent base from which market offer discounts could be calculated[1].

6. Do you agree with our proposed approach to continue using the DMO 2 wholesale energy cost forecasting methodology?

ActewAGL supports the proposed approach.

7. Do you agree with our proposed approach to continue using the DMO 2 environmental costs methodology?

ActewAGL supports the proposed approach.

8. Do you agree with our proposed approach to continue using the DMO 2 network costs methodology?

ActewAGL supports the use of approved network prices for 2021–22 as the basis for the AER's final decision on the DMO for 2021–22. ActewAGL does not support the use of unapproved network prices for the final DMO decision (where approved prices are not available) due to the risk of retailers being undercompensated for network costs. ActewAGL proposes the AER seek to change the DMO determination date to provide additional time for the AER to calculate DMO prices based on approved AER network prices.

9. Is it reasonable to apply a productivity factor to the DMO? What is the evidence retailers' costs are decreasing or increasing?

The DMO was not intended to be determined on a cost-based bottom up approach, nor was it intended to be the cheapest offer. This is demonstrated by the DMO determining retail costs as a simple "residual" amount that includes retail operating costs, implied retail margin as well as other costs not specifically identified by the AER.

ActewAGL considers it unreasonable to apply a productivity factor to the "residual" amount, because it includes costs that are not related to the productivity of a retailer's internal operations.

If the AER was to apply a productivity factor to the "residual" amount (as currently defined), the outcome would be a lower allowance for the retailer's operating costs (which are related to productivity), but also for the retailer's margin and payment of other unspecified and potentially fixed costs.

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[1] AER 2019, Final Determination Default Market Offer Prices 2019–20, Australian Energy Regulator, Melbourne, Vic

10. What form should any productivity adjustment take?

ActewAGL does not support the introduction of a productivity adjustment as part of the DMO as outlined in question 9 above.

11. Do you agree with our proposed approach to continue using the DMO 2 step change framework?

ActewAGL supports the retention of the DMO 2 step change framework.

12. What will be the impact of COVID-19 on retailer costs in 2021-22? Are any retailer costs decreasing due to COVID-19?

The major categories of retail costs identified during consultation as impacted by COVID-19 continue to be a concern for ActewAGL. In particular, the risk of retailer costs rising as a result of bad debts. It is ActewAGL's view that bad debt write-offs will increase during 2021/22 when collection activities resume.

ActewAGL has not experienced any reduction in costs as a result of COVID-19 and is not expecting to do so in the future.

13. What is the basis for estimating any cost impacts? Please provide information to assist with estimating cost changes associated with COVID-19.

ActewAGL supports the use of the DMO retail costs step change framework to recognise the cost impacts of COVID-19 on retailers.

In estimating the cost changes associated with bad debts, the AER can utilise the weekly and quarterly debtors information reported by retailers to determine the impact on the market as a whole. This will help inform the most appropriate amount to include in the setting of DMO3.

14. What impact will meeting CDR obligations have on retailer costs in 2021-22? What is the basis for estimating any cost impacts? Please provide relevant cost information to assist with estimating cost changes associated with CDR.

ActewAGL is not in a position to provide cost estimates for CDR implementation at this time. The range of possible approaches to implementation currently being explored means there is not sufficient information on the final rules to make a robust assumption of the likely costs.

15. Aside from CDR and COVID-19, are there other regulatory or operating environment changes that are likely to materially increase or decrease retailers' costs to serve customers in 2021-22?

Other regulatory or operating environment changes that are likely to materially change retailers' costs to serve customers in 2021–22 include:

- System and business process changes required to comply with Five-minute and Global settlements regulatory changes

- System and business process changes required to comply with the customer switching rule changes
- National Energy Retail Amendment (bill contents and billing requirements) rule[2]

16. Do you agree we should retain the same annual usage amounts used for DMO 2? If not, what alternatives are more appropriate and what are their benefits?

ActewAGL supports the model usage amounts from DMO 2.

17. What is the appropriate level of detail to include in the daily usage profile? What are the risks and benefits of a simple TOU profile compared to a detailed one?

ActewAGL supports the retention of the existing time-of-use profile format (option 1). In ActewAGL's view, option 1 balances the need for a reference price to be easily understood and also broadly reflective of the usage profile of a TOU customer. The other options may produce a slightly more accurate reflection of the load profile of a time-of-use customer, however, as the original intention of the DMO was to 'broadly' represent customer usage, ActewAGL considers option 1 best achieves this purpose.

18. Do you agree our DMO 2 approach to advanced meter costs remains appropriate for DMO 3?

ActewAGL does not support the approach adopted in DMO 2 with respect to advanced metering costs. Electricity metering is an essential cost incurred in the provision of electricity services. Thus, regardless of the meter type and responsibility, all metering costs (capital, operating and maintenance) must be included in the DMO. The approach used in DMO 2 does not adequately compensate retailers for the materially higher cost of Type 4 meters compared to Type 5 and Type 6 meters.

The reasons for this view are outlined in the responses to question 19 and question 20 below.

19. If not, what is the evidence that advanced metering costs are impacting retailers' abilities to recover their costs to serve standing offer customers?

Advanced metering costs impact on a retailer's ability to recover their costs to serve standing offer customers. The cost of a Type 4 meter is higher than the cost of a Type 5 and Type 6 meter, as outlined by the AER (referencing the Queensland Competition Authority[3]). The proportion of Type 4 meters in the market is also increasing every year as older meters are withdrawn from use. Thus, the metering cost allowance embedded in the DMO (which is based on Type 5 and Type 6 meters) is becoming less relevant each year as the proportion on Type 4 meters rises.

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[2] Taylor, A, Better Bills: AEMC Rule Change Request, The Hon. Angus Taylor, Minister for Energy and Emissions Reduction.
[3] AER 2020, Position Paper Default Market Offer Prices 2021–22, Australian Energy Regulator, Melbourne, Vic, pg. 51

20. Is it reasonable to increase the DMO price for flat rate standing offer customers to take account of the higher costs of advanced metering?

Flat rate standing offer customers can be serviced by either Type 4 (advanced metering), Type 5 or Type 6 meters. As a result, ActewAGL considers it is reasonable to account for the higher costs of Type 4 metering when setting the DMO price for flat rate standing offer customers. ActewAGL deems this necessary in order to maintain a single DMO price regardless of a customer's metering configuration[4].

A flat rate standing offer customer may have a Type 4 meter for a number of reasons. For example, following the installation of a Type 4 meter and subsequent default assignment to a cost-reflective network tariff, the customer may choose to opt-out to a flat retail tariff.

Setting the DMO price for flat rate standing offer customers to take into account the higher costs of Type 4 meters would be consistent with the recent decision by the ICRC (June 2020[5]) to include an allowance for advanced metering in the ACT standing offer regulated cost index model. This decision recognised the higher costs of Type 4 meters compared to Type 5 and Type 6 meters.

21. Do you agree our DMO 2 approach to costs to supply solar customers remains reasonable?

ActewAGL agrees that the approach used in DMO 2 in regard to solar customers is reasonable, provided the AER accounts for the higher costs of Type 4 meters compared to Type 5 and Type 6 meters when setting the DMO price.

ActewAGL does not support the implementation of separate DMO prices for solar and non-solar customers. Adjusting the DMO to account for the proportion of customers in a particular network region with Type 4 meters should go some way toward addressing the higher costs of servicing solar customers compared to non-solar customers. The cost difference largely stems from solar customers requiring more expensive metering installations based on historic actual meter fleet data.

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[4] That is to say, one price for residential customers without controlled load, and one price for residential customers with controlled load, regardless of whether a Type 4, Type 5 or Type 6 meter is installed at a customer's premises.

[5] ICRC 2020, Retail Electricity Price Investigation 2020–24 Final Report, Report 9 of 2020, June 2020, Independent Competition and Regulatory Commission, Canberra, ACT, pg. 6