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Default Market Offer Prices 2023-24 – Draft Determination

Alinta Energy welcomes the opportunity to comment on the Australian Energy Regulator's draft determination on the default market offer for 2023-24.

Alinta Energy is an active investor in energy markets across Australia with an owned and contracted generation portfolio of over 3,300MW and more than one million electricity and gas customers. The final DMO for 2023-24 (DMO5) will impact customers, retailer viability and effective competition in the retail energy market as the AER seeks to balance the DMO's objectives of customer protection, effective retail market competition and maintaining confidence that retailers can recover their costs.

General comments

Alinta Energy supports the consistency in approach the AER has generally applied in its draft determination for DMO5, with some exceptions. It is well understood that the primary driver of changes to the DMO is a function of wholesale energy costs (WEC) where the Essential Services Commission has also noted the impact of wholesale market volatility in its draft determination on the Victorian Default Offer for 2023-24.

It is critical that the DMO remains a credible reference price and reflects the costs of a prudent retailer competing in the jurisdictions to which it applies. Certainty in the approach to its determination will support effective competition and allow retailers to invest and innovate to attract new customers. Whilst also ensuring that retailers can continue to invest in services that provide assistance to customers experiencing vulnerability. While price regulation of the retail energy sector is clearly a second-best outcome to competitive rivalry, the AER in general has struck a balance in its draft determination that meets the objectives of the DMO.

The decision to apply the 75th percentile of wholesale market outcomes for DMO4 at a time of unprecedented volatility in the National Electricity Market is a change that exposed retailers to significant risk. Alinta Energy would ask the AER to consider changing this approach to prevent further retailer exposure and potential failures going forward. While retail market entry and exit are a normal feature of a competitive market, we believe a more conservative approach in the current wholesale market environment is warranted.

Where costs cannot be determined or estimated, for example compensation costs associated with the suspension of the wholesale market in 2022, these must be included in future DMO determinations once known.

Alinta Energy makes specific comment on elements of the draft determination below.

Wholesale Energy Costs

The draft determination largely reflects the impact of wholesale market volatility over the 2022 calendar year, which required retailers to recover the cost of hedging against high wholesale market prices over that period. However, significant uncertainty remains over the direction of wholesale market, and price volatility over the next few years, requiring the AER to maintain consistency in the method of estimating the WEC component of the DMO. Consistency in approach will support retailer confidence, effective competition and serves the long-term interests of consumers.

Application of the 75th percentile

The application of the 75th percentile of simulated wholesale market outcomes in determining the WEC component of the DMO is not reflective of the market risks facing a prudent retailer, as evidenced by the wholesale market volatility that occurred during 2022. Alinta Energy recommends the AER reinstate the 95th percentile for DMO5 and failing this, consider the impact that sustained wholesale market volatility would have on a prudent retailer and their capacity to remain financially viable. The failure of a record number of retailers during 2022 indicates that the allocation of risk and the need for an allowance to support ongoing viability requires further consideration.

Load profiling

Alinta Energy supports the earlier inclusion of interval and smart meter data for small customers in some form for DMO5. Delaying this on the basis that it may limit "any possible step change to the wholesale cost from this transition"[1] risks amplifying a step change for DMO6 in 2024-25. Given this, a hybrid of actual smart meter data should be substituted into the load profile approach to reflect the pattern of actual demand.

AEMO and AEMC compensation costs

Alinta Energy supports the inclusion of known compensation cost in the WEC for DMO5 and a commitment to include future costs when known. This may not take place until DMO6 is determined in 2024.

However, retailer's lost hedging revenue - acknowledged by the Essential Services Commission in its consultation on the determination of the Victorian Default Offer - should be considered as a part of a retailer's prudent costs, as there is no compensation system available to retailers to recover lost hedging costs due to capped streams of revenue due to market intervention.[2]

Network costs

Alinta Energy welcomes the AER's use of updated information provided by the distributors in determining the network cost component of the draft DMO for DMO5. The inclusion of better estimates of network tariff cost drivers feeding into the draft determination will improve the DMO final determination. We remain strongly of the view that the DMO determination should

[1] AER (March 2023), Draft determination – Default market offer prices 2023-24, page 26.
[2] ESC (December 2022), Consultation paper – Victorian default offer 2023-24, page 12.

not be delayed by network determinations (which are only one component of the DMO) and that these should be finalised by the end of the first quarter of a calendar year at the latest.

We support the inclusion of New South Wales Renewable Energy Zone costs for the NSW distribution network service providers for DMO5. Ignoring these costs would result in higher DNSP costs in NSW for DMO6 in 2024-25.

Retail costs

Bad and doubtful debts

We are concerned with the draft allowance proposed for bad and doubtful debts in DMO5. While the use of data provided by retailers obliged to publicly report is used as a proxy for bad and doubtful debt for a prudent retailer, this data is not disaggregated by customer class and is likely to underestimate the relative debt level for small customers. Given the current challenges and cost of living pressures facing many consumers, it does not seem plausible that bad and doubtful debts will *fall* by 38% over the 2023-24 financial year.

An alternative to using publicly reported data on bad debt from a select few retailers would be the application of an accepted benchmark (for example, percentage of turnover) or the use of actual bad and doubtful debt figures from retailers themselves. While relying on retailers that publicly report may cover a majority of small customers, it does not mean this reflects the costs to a prudent retailer or smaller retailers.

Retail allowance

Alinta Energy supports retaining the previously proposed retail allowance glide path on the grounds that the AER should, in the absence of identifying evidence of a shortcoming in previous determinations, maintain a consistent approach to determining the DMO.

The DMO is a reference price, not the price that most customers pay (as most customers choose market offers). Arbitrarily constraining elements of the DMO impacts choice for consumers in the competitive retail energy market and is inconsistent with its objective.

We would welcome further discussion of this response with the AER, please contact David Calder (David.Calder@alintaenergy.com.au) in the first instance.

Yours sincerely

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