Response to draft DMO

AER public forum, 31 March 2023

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Overview

- Overall, Energy Locals agrees with the draft DMO determination and welcomes that the historic methodology has been applied consistently.
- Consistency of process builds trust and demonstrates transparency, which helps market participants to plan.
- We also welcome that the Draft DMO determination clearly called out the major challenges facing retailers in the last 12 months, specifically:
  - Increase funding challenges due to rapid price increases and margin calls.
  - Reduced hedging options due to clearing house withdrawals.
- Preserving competition will lead to better outcomes for customers.
  - 7-17% discounts to DMO for residential; 9-26% for small business.

- Regardless, we note the pain that this will cause many customers as a result of unreasonably high wholesale prices. The market cannot continue in its current form.

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Wholesale cost allowance

- Clearly the most contentious item.
- Overall, we believe the allowances are a fair reflection of the hedging costs retailers have faced.
- However, we also note that many retailers won’t have finished hedging for FY24 yet.
- Note the reduced liquidity with the departure of clearers.
  - ASX access now offered by a large bank, but with added transaction costs.
- Believe that OTC hedging is at a higher cost than trading directly via the ASX and will seek to provide this evidence to the AER.

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Challenges retailers are dealing with

- We believe the AER should contemplate market participant funding obligations in its methodology:
  - Need to maintain cash buffers to cater for AEMO margin calls and prudential requirements, which have increased significantly.
  - Higher cost of capital due to interest rises and the perceived increase in risk related to the sector.

- The emphasis on a 2-3 year hedging horizon puts small, fast growing retailers at a disadvantage:
  - Energy Locals has ~tripled its direct customer base between Dec 2020 and Dec 2022.
  - Retailers that bring additional competition and innovation to the market can't meaningfully hedge over a 2-3 horizon.
  - Related prudential costs makes the extended hedging strategy unviable due to mark-to-market exposure.

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Challenges retailers are dealing with (cont'd)

- The DMO sets out the glidepath of the Retail allowance to 10% for retail customers and 15% for SMEs.

- The draft determination notes that this reflects an increase in *nominal* terms driven by the higher costs in other components of the cost stack.

- We'd like to emphasise again that this should appreciate the increased costs (eg bad debts and working capital costs) which are directly linked to the overall increase in cost.
  - We note the AER has not received retailer data on bad debt other than that which is publicly available.
  - Energy Locals will provide this (confidentially) in its Draft DMO submission.
  - Note that coal generators that didn't contract coal supply have been compensated for increased costs.

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The Retailer Reliability Obligation unnecessarily drives up costs for customers

- The RRO is flawed.
- It requires retailers to hedge a year in advance but does not require the purchaser of the hedge to hold it to maturity.
- What this mean is vertically integrated businesses simply ‘sell’ a contract between departments while small retailers buy on market.
- Astute traders are aware of this and push the price of the contract up, knowing that retailers have no choice but to buy the contract to comply with the rules.
- This reduces competition, drives up costs for customers and despite this and the excessive public money spent designing the RRO, it’s unlikely to fix the problem it’s aimed at solving.

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Should the methodology change if we don’t like the answer?

- We think not, or there’s no foundation for market participants to plan effectively, and that would likely lead to even more unpredictable outcomes for consumers.

- But we do support tacking the systemic issue that is having the greatest contribution to poor outcomes for consumers.

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This DMO follows a sound methodology that monitors a flawed market

- A generator with 6 units of equal output earns more if the market price jumps by 20% when one of its units trips. Less supply for customers, more money for generators:

	Units	MW/unit	Hours	Market price $/MWh	MWh generated	Revenue		
BAU	6	50	1.0	80	300	24,000		
One unit trips	5	50	1.0	96	250	24,000	20%	Wholesale price jump required
Two units trip	4	50	0.5	15,000	100	1,500,000	6150%	Less output, 61x revenue

- While wholesale price caps may discourage investment, precedent exists for other solutions

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How can we all help customers with the most volatile component of the cost stack?

Examples

- NSW ETEF scheme
- Used to keep wholesale prices in balance
- May not work perfectly in today's market design, but it worked – and NSW saw significant investment during this period

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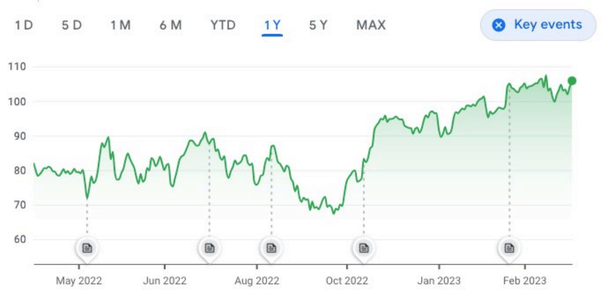
- The UK 'windfall tax': runs for another 5 years.
- Electricity Generator Levy: some excess profit levied.
- If distributed evenly, results in hundreds of dollars per household per year to offset higher prices while preserving competition
- None of them went bust as a resu



The NEM increases rewards for participants when fewer customers can afford electricity.

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How else can we all help customers?

- Smart meter costs in AER States are 3x what customers in Victoria pay. Why?
- Network tariffs increasingly look highly rational to economists but hieroglyphic to customers. Simple price signals needed. A *simple* ‘hardship’ network tariff would help.
- Customers in hardship should not have to pay for environmental certificates so that other customers can get an even shorter payback on solar PV.
- Reduce retail overheads in line with simplification of retail rules and reporting.

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Thank you

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