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Mr Mark Feather
General Manager, Policy and Performance
Australian Energy Regulator
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Dear Mr. Feather

Retail electricity prices review - Determination of default market offer prices

Meridian Energy Australia Pty Ltd and Powershop Australia Pty Ltd (Powershop) thanks the Australian Energy Regulator (AER) for the opportunity to provide comments on the AER Draft Determination - Default Market Offer Price (DMO).

The MEA Group is a vertically integrated generator and retailer focused entirely on renewable generation. We opened our portfolio of generation assets with the Mt Mercer and Mt Millar wind farms. Subsequently, in early 2018 we acquired the Hume, Burrinjuck and Keepit hydroelectric power stations, further expanding our modes of generation. We have also supplemented our asset portfolio by entering into a number of power purchase agreements with other renewable generators, and through this investment in new generation we have continued to support Australia's transition to renewable energy. The Powershop has also been active in supporting community energy initiatives, including providing operational and market services for the community-owned Hepburn Wind Farm, supporting the Warburton hydro project, and funding a large range of community and social enterprise local energy projects through our Your Community Energy program.

With respect to the group's retail side, we also own and operate Powershop Australia, an innovative retailer committed to providing lower prices for customers and which recognises the benefits to customers in transitioning to a more distributed and renewable-based energy system

As you would be aware, Powershop does not support the proposed DMO as we consider that is highly likely to have an adverse impact on customers in terms of price, access to competitive and innovative offers, and reliability. We also consider that is highly likely that the DMO will reduce innovation, customer service and investment in required generation and also cause a decline in competition across the entire energy sector.

This view is supported by the AEMC in their 'Advice to COAG Energy Council: Customer and competition impacts of a default offer'. The AEMC found that a reduction of 10% in the average standing offer in Queensland would likely require retailers to increase their market offers to above the new standing offer rate.

We acknowledge that the decision to develop a DMO was not the AER's and that the AER is required to implement the proposed DMO. However, in implementing the DMO the AER should be guided by the National Electricity Objective (NEO), which has been adopted market-wide by all jurisdictions including the Federal Government.

In particular, the NEO requires a focus on the promotion of:

"*efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:*

*price, quality, safety and reliability and security of supply of electricity; and*

*the reliability, safety and security of the national electricity system*"

In light of the AEMC advice, and its focus on competition and investment impacts, it is imperative that the AER in first implementing the DMO takes a cautious approach to setting the initial default prices. This includes considering the risk that the simplified approach adopted (e.g. excluding TOU, solar and demand customers) may inadvertently result in a too low default price being set. It is also particularly concerning that the proposed prices are at, or approaching, the levels that the AEMC considered likely to effectively eliminate competition and result in engaged consumers losing most, if not all, of the advantages of the competitive market.

Specifically, we would like to note that the AER's draft determination approach includes numerous assumptions, assessments and judgments, which cumulatively add risk to the determination of the DMO price. These include amongst other things:

(i) AER's "analysis showed little difference in the observed median market and standing offers outcomes when data from 1 July 2018 to 31 October 2018 was used, compared to use of data from 1 October 2018 to 31 October 2018". Offers made in the period 1 July to 31 October 2018 would likely to have been based on retailer's internal views of the underlying costs for the 2018-19 year as at May 2018 or earlier, rather than October 2018. While the AER have assessed the variation in offers between July and October, there appears to have been no assessment of whether this similarity is due to consistency in underlying costs or other factors (e.g. changes in competitive behaviour combined with variations in underlying costs). There is a real possibility that the use of the October offers will increase the risk of a mis-calculation of the initial default price.

(ii) AER is not proposing to adjust the proposed DMO price for expected changes in costs. As it is considered that the estimated forecast changes in key inputs cost components between 2018-19 and 2019-20 is modest. However, there are a number of assumptions and issues:

- the time period to assess changes in forecast costs are inconsistent and should be assessed as at May 2018 and May 2019 ie closer to the DMO period. This will enable the change in wholesale cost and hedging assumptions used in the DMO analysis to more appropriately align with the AEMC wholesale estimate based on the EY modelling;

- assumptions on environmental costs have not yet been updated to reflect the recently published renewable power percentage (RPP) and the small-scale technology percentage (STP), nor has an assessment of the impact following the non-surrender and under-surrender of LGCs for the 2018 calendar year;

- forecast metering costs have not be updated to take into consideration the higher costs associated with third-party (non-distributor) contestable smart meters, noting additional meter recovery and other costs. For example, Powershop has a substantial number of customers on smart meters as a response to the Power of Choice rule change, the change to net metering for solar customers and provision of usage data to encourage demand response and reduce usage. All of these changes were implemented in response to government and regulatory encouragement and it is likely as a consequence that these costs will continue to increase. As such, it would be inappropriate to exclude these costs from underlying costs; and

- it is unclear whether cost to serve assumptions (or wholesale risk assumptions) take into account increases over time in regulatory costs, bad debts and working capital requirements (including prudential costs) due to cost of living and macro-economic pressures, increased regulatory requirements and increased customer enquiries (e.g. in response to the Federal government's "Make the Call" campaign). For example, a prudent retailer would be expected to increase provisions for bad debt in 2019-20 due to the AER's changes to the hardship provisions and the expected impact of forecast negative economic conditions.

(iii) AER accepts that some retailers allow for a proportion of customers not taking up conditional discounts in setting market offers to recover their efficient costs. In addition, some retailers, depending on their growth strategy, risk appetite and wholesale positions will set market offers below a level to recover their efficient costs. In addition, we note that the AER has taken the median of all of the generally available market offers (excluding restricted offers), even though it is likely that a very small percentage of customers will be on the very lowest priced offers, many of which have significant restrictions. The more appropriate and accurate method would be to take a weighted average and also take into account what percentage of customers access any conditional discounts. While the AER notes that some of this is taken into account in setting DMO prices within the specified range, it is by far not a certain or calculated assumption. In these circumstances there is a very real risk that the calculated default price will substantially underestimate the appropriate median market offer.

(iv) It is unclear how or where in setting the DMO price the AER has taking into consideration the policy objective of "Not dis-incentivising competition and market participation by customers and retailers". As the AEMC advice clearly sets out there is a major risk that setting the default prices at the proposed levels has the very real potential to reduce participation and competition by retailers and substantially reduce the benefits customers will achieve from participation in the market. Also, Powershop has consistently incurred costs for innovation and development to improve customer experience, service standards and product options. These costs are essential to enable Powershop to compete on non-price terms and deliver the innovation which is driving long term market-wide customer benefits including lower costs and reduced consumption. Consideration of these costs is especially important during the current energy transformation to an increased reliance on renewable energy and decentralised participation, as the market will become increasingly reliant on retailer led innovation such as demand response, virtual power plants and peer to peer trading.

In light of the above, we consider it dangerous for the AER to proceed with the proposed prices. We strongly urge the AER to consider setting initial default prices at 80% of the difference between the median standing offer and the median market offer rather than the 50% currently being proposed.

This would allow the DMO to proceed while reducing, but not eliminating, potential impacts on prices, competition, innovation and investment. We encourage the AER to seriously consider the potential for the DMO to significantly adversely affect Australian consumers, the energy market and ultimately the Australian economy.

If you have any queries or would like to discuss any aspect of this submission please do not hesitate to contact me.

Yours sincerely

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