

11 April 2023

Stephanie Jolly
General Manager, Market Performance
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Lodged by email: DMO@aer.gov.au

Dear Stephanie,

RE: Default market offer prices 2023-24 Draft determination paper

Powershop is an innovative retailer committed to providing low prices for customers and which recognises the benefits to customers in transitioning to a more distributed and renewable-based energy system. Powershop has introduced several significant, innovative and customer-centric initiatives into the retail energy market, including the first mobile app that allows customers to monitor their usage, a peer-to-peer solar trading trial and a successful customer-led demand response program.

Statement

Powershop empathises with our customers in the current economic climate and the pressures of affordability for numerous essential services that impact the cost of living. Powershop already provides its customers with various supports and mechanisms to assist customers to reduce their energy debt. We will continue to do this as a priority.

However, Powershop does not support the draft decision made by the Australian Energy Regulator (**AER**) on a range of issues (including matters raised in our submission to the AER's Default Market Offer (**DMO**) consultation in November 2022). Powershop is concerned that the AER is diverting away from the methodology of its price cap mechanism to drive short term outcomes, but in doing so will have detrimental consequences in the longer term. If the DMO does not fairly reflect market conditions, then the costs to consumers, whilst in part, are shielded for now, will be potentially far greater in following DMOs.

The DMO is not a tool that should be used to address affordability. The DMO is a tool that should reflect the realities of the energy market. Powershop does not agree with the approach taken for retailer margins in the draft decision which is a departure from the allowance glidepath, nor did we agree with the hedging decision of DMO4 that increases financial risks to retailers in the circumstances of high pool price events. The volatility of the energy market in 2022 has shown that decision to be contentious.

There are many mechanisms and support opportunities that the AER could pursue with various stakeholders including government to address affordability rather than using the DMO and in doing so, deviating from the DMO's original objectives. Powershop is supportive of further support for customers experiencing vulnerability through these mechanisms outside of the DMO.

Wholesale Methodology

Powershop does not support the AER's draft determination to continue to "maintain the current wholesale methodology for all DMO regions for DMO 5, which relies on futures contracts traded on the ASX for base, peak and cap contracts"¹.

Powershop advised the AER's consultation paper that we were more open to the use of options, regarding the current hedging strategy as sufficient. We also requested acknowledgement "that exotic products may be used to hedge market risks when the standard products are insufficient"².

Powershop reiterates that the AER should acknowledge retailers hedge their market risks using a range of products (i.e., retailers do not all hedge in a broad, vanilla way). Powershop believes this is pertinent at times when standard trading products are not the appropriate products for some retailers when considering load profiles, or low liquidity.

Over the Counter (**OTC**) options are routinely utilised for hedging by smaller retailers who are not vertically integrated. It is not indicative of many retailer strategies, nor appropriate that the DMO isolates only the ASX trading and price setting indicators.

Powershop believes the hedge book build period cannot hold for 3 years. The volatility of 2022 and transitioning of the energy market makes hedging products over a 3-year period almost impossible to maintain. In fact, Powershop is sceptical that there are any retailers in the market that are hedging for a period of 3 years. This is due to a constantly changing customer segment, subsequently significantly changing electricity loads.

Powershop stated above that the DMO should reflect how an efficient retailer would operate. This is particularly relevant for how long the book build should cover. The DMO should reflect the reasonable expectations of an efficient retailer's behaviour to manage risk rather than to drive price outcomes.

Therefore, Powershop argues the contracting period should cover a period of no less than 12 months and no more than 2 years.

Forecasting risk premium

There were eleven submissions from retailers including Powershop that advised a change of the forecasting estimation method back to a risk position of the 95th percentile (from the just recently changed 75th percentile) would be appropriate. The change in DMO4 to the 75th percentile failed to contemplate significantly material events including the wholesale market events of 2022. This pending volatility in the market was known prior to the final DMO4 decision.

By not moving the methodology back to a 95th percentile projection, the approach fails to acknowledge the significant hedging risks a retailer has had to undertake in 2022. The decision also confirms an inconsistency in application of DMO methodology by the AER in not adjusting this benchmark.

¹ AER, Default market offer prices 2023-24: Draft Determination, page 23

² Powershop Australia, submission to AER Default Market Offer prices 2023-24, Issues paper, page 1

The AER looks to be ignoring the range of material outcomes and considerable risks to retailers beyond the 75th percentile. Powershop believes an adjustment back to a 95th percentile approach merely acknowledges the volatility through the market in 2022 but also for any future volatility during this transition period.

We believe the AER should also compare the outcomes of shifting to the 95th percentile approach compared to the 95th percentile approach in light of the extreme market events that occurred during the DMO4 period.

Retailer Reliability Obligation

Our submission to the AER's issues paper referred to the calling of the T-1 instrument under the Retailer Reliability Obligation (**RRO**) in South Australia in 2024 and the issues created for trade volumes and costs in a particular period. The call has potentially negatively impacted trade volumes and reduced liquidity.

Powershop's understanding on the approach taken by the AER is to assume swaps for average demand, then caps for the median peak demand value (based on forecasts). However, the AER should consider and factor into the final DMO that the market needs to be hedged for higher than that value (3044MW conservatively and likely to exceed this given the uncertainty in forecasting customers' peak load at this time), and that this had to be done before 8 January 2023.

Powershop reviewed the ACIL Allen report for the DMO³ and advises Figure 4.23 confirms that a retailer may be exposed to RRO compliance risk in South Australia, with contract cover up to approximately 1300MW. Subject to translation as a proportion of total SA load, the forecasts include a peak demand event in that period of 1600MW. Therefore, there is a material cost and compliance gap that could expose retailers to penalties under the RRO if ACIL Allen's contracting estimates are too low.

Powershop requests the AER to again consider the impact of the RRO in the development of the wholesale cost element of the DMO and ensure that this DMO is adjusted to fully reflect retailer costs under the declared RRO.

Retail Allowance

Powershop does not support the Paper's decision to move away from the consistent application and glide path approach to determining a retailer's retail allowance. Whilst Powershop supports the continued approach to apply the retail allowance as a percentage of total costs, we do not support making exceptions to its methodology, based only on expected costs in the DMO.

It is our view that retailers should not be burdened with further risks because of expected high prices in the South Australia Power Networks region or the Energex region. The glidepath should not be paused to artificially suppress the true costs in the pursuit of short-term outcomes as this approach disregards the DMO's objective of allowing retailers to recover their costs and compete.

A consistent and predictable approach is important for retail market confidence and to maintain incentives for competition, innovation and investment. The DMO and its glidepath should be applied based upon market realities. Powershop believes that this draft decision increases the financial burden in future years to 'catch up' with the glidepath.

³ ACIL Allen, Default Market Offer 2023-24 Wholesale energy and environment cost estimates for DMO 5 Draft Determination

Coupled with this inconsistent approach to the wholesale methodology above, applying an inconsistent allowance from region to region reduces the credibility of the DMO as an effective price regulation mechanism that still promotes competition and innovation.

With obvious, increased intervention and market challenges that retailers are facing (e.g. market suspension costs and RERT costs), as well as the challenges of energy transition, it would be appropriate to maintain a retail allowance that provides sufficient coverage to weather these risks.

This creates a potentially risk laden approach when one also considers there is no mechanism to allow for a revised DMO to accommodate materially significant market events (that occurred in 2022). The AER should strongly consider maintaining a consistent glidepath given retailers are the sole bearers of the supply chain credit risk.

Powershop agreed with other retailers that with forecast wholesale price increases, “the increase in wholesale energy costs and volatility has a proportionate impact on the risks faced by retailers – therefore, it is appropriate to increase the retail allowance to reflect the increased risk to retailers”⁴.

Consumer Data Right

Powershop will provide the AER with data confidentially that confirms the costs that Powershop has incurred per customer in relation to the implementation of the Consumer Data Right, which we consider should factor into the final decision for this DMO.

Conclusion

Powershop thanks the AER for the opportunity to provide comment and we would welcome further engagement with the AER on the points highlighted through this submission. If you would like to discuss, please contact Alan Love at alan.love@powershop.com.au.

Yours sincerely,

Libby Hawker
GM Regulatory Affairs and Compliance

⁴ AER, Default market offer prices 2023-24: Draft Determination, page 40