PO Box 4136
East Richmond VIC 3121
T 131 806
F 1300 661 086
W redenergy.com.au

PO Box 4136
East Richmond VIC 3121
T 1300 115 866
F 1300 136 891
W lumoenergy.com.au

6 April 2023

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

Submitted electronically: DMO@aer.gov.au

Dear Ms Jolly,

Re: Draft determination: Default market offer prices 2023–24

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to comment on the Australian Energy Regulator's (AER's) draft determination for the Default Market Offer to apply from 1 July 2023 (DMO5).

The AER proposes a significant increase in regulated retail prices, which follows a similarly large increase in DMO4. As the AER notes, this is largely due to 'unprecedented supply challenges and volatility'. Red and Lumo are very mindful of the consumer impact of these price rises, particularly for those experiencing payment difficulties. However, it is important for stakeholders to consider the role of the DMO in the context of other regulatory protections.

The DMO is one of numerous consumer protection measures. As the AER states, it is intended to protect consumers on standing offers from unreasonably high prices, while also allowing retailers to recover costs and earn a reasonable return, and to encourage competition and market participation. These objectives may seem contradictory to some at a time when underlying costs are increasing.

However, the DMO cannot—and was not designed to—completely insulate consumers from the impact of increasing costs that are the result of underlying structural factors. Suppressing the DMO to address concerns about vulnerability would place greater emphasis on one policy objective at the expense of others and would have a harmful impact on consumers over the longer term. It would further erode retail margins, which the Australian Competition and Consumer Commission notes are at historically low levels, and threaten retailer viability.[1] As the events of 2022 show, retailer failures cause significant disruption for impacted consumers.

[1] Australian Competition and Consumer Commission (2022), *Inquiry into the National Electricity Market – November 2022 Report*

Furthermore, a determination that does not account for actual costs or allow retailers to earn a reasonable return will undermine competition, discouraging new entry and innovation in pricing and other elements of retail offerings that will be essential to achieving an orderly and efficient transition. This is ultimately to the detriment of all consumers.

Our strong recommendation to the AER is to rely on other consumer protections to support vulnerable consumers, most notably the *Hardship Guideline*. This is the most targeted, proportionate and effective mechanism for ensuring that any consumer experiencing payment difficulties will receive the support they need to deal with higher energy prices. Red and Lumo are also active participants in the AER's *Game Changer* initiative, which is considering options to improve the effectiveness and efficiency of the support that retailers must provide to their customers.

DMO determinations must always reflect best practice price regulation irrespective of the direction of price changes. For this to occur, the AER must ensure that its determinations are based on stable, predictable, and consistent methodologies. We acknowledge that methodologies can change but this should only occur when it is clear that a better approach exists or when better data becomes available, and following effective stakeholder consultation. Getting this balance right will ensure the DMO prices are not unjustifiably high while allowing retailers to recover their reasonable costs.

Accuracy of forecasting wholesale costs

Red and Lumo welcome the AER's decision to continue to apply its current methodology for determining Wholesale Electricity Costs (WEC). ACIL Allen notes that its methodology will produce a smooth WEC estimate trajectory – '*underestimating outcomes in an increasing price environment, and overestimating outcomes in a decreasing price environment*'.[2]

As we have stated, we support a stable and consistent approach and any differences between actual and estimated costs for any specific retailer that reflects its individual hedging strategy will smooth out over time if this consistency is maintained. Red and Lumo would not support any short term adjustment to DMO5 in response to higher wholesale costs that are not applied in a symmetrical way.

[2] ACILAllen (2023), *Default Market Offer 2023-2024: Wholesale energy and environment cost estimates for DMO 5 Draft Determination*, page 30

System load profile

Both the AER and ACIL Allen acknowledge that the AER should begin incorporating smart meter data into its calculation of the load profile, rather than relying on Net System Load Profile (NSLP). This would more accurately reflect the load that retailers must manage and the actual hedging costs they incur.

The NSLP that is currently applied for the purposes of calculating the DMO assumes the majority of residential and small business customers are on accumulation meters. However with the continual roll out of smart meters the majority of customers in these jurisdictions will be on smart meters in the next few years, with the Australian Energy Market Commission issuing a draft recommendation to achieve 100% penetration by 2030.

We acknowledge the AER's concerns about the transparency of load profile data from interval meters. However, data that the AER could obtain from networks is sufficiently rigorous to provide a basis for assessing the materiality of the difference between the two approaches.

Retail allowance

Red and Lumo are concerned the AER is proposing to halt the proposed glidepath for allowable margin in the SAPN and Energex distributions areas for residential customers without control load. The AER is choosing to depart from its previously stated approach and this decision is to mitigate price increases for these customers that the AER considers to be too high, rather than responding to new data or information, or an improvement in methodology. This type of asymmetric approach will only undermine confidence in the stability of the framework and we strongly encourage the AER to reconsider.

Compensation

Red and Lumo support the inclusion of estimates for compensation costs arising from AEMO's energy directions and other market actions during 2022. While acknowledging that the draft determination has only included an allowance for 'known' compensation costs, we continue to recommend that the AER liaise with the Australian Energy Market Commission to understand the likely materiality of the costs that are yet to be calculated with a view to including an allowance.

In particular, smaller retailers may be exposed to significant costs during 2023/24 that they cannot recover if the AER does not include an allowance.

Unaccounted for Energy

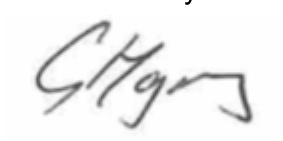
Red and Lumo recommend that the Net System Load Profile (NSLP) should be adjusted for Unaccounted for Energy (UFE) given it is applied across all retailers following the introduction of global settlements. For this to occur, AEMO would be required to publish the relevant data on UFE. In addition to this, the AER would also need to obtain NSLP data from AEMO. For 2021-22, we note that the NSLP data has become unreliable following the introduction of 5 minute settlement. As the data 'settles', UFE could be used to adjust it. We would welcome the opportunity to work with AEMO to support the delivery of the data as required.

About Red and Lumo

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales, Queensland, South Australia and in the ACT to over 1.2 million customers.

We thank the AER for the opportunity to comment on the draft determination. Should you wish to discuss aspects of this submission or have any further enquiries, please contact Con Noutso Regulatory Manager on 0481 013 988.

Yours sincerely



Geoff Hargreaves
Manager - Regulatory Affairs
Red Energy Pty Ltd
Lumo Energy (Australia) Pty Ltd