Government of South Australia
Department for Energy and Mining

Our Ref: D21043965

Ms Stephanie Jolly
General Manager, Market Performance
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Dear Ms Jolly

Default Market Offer prices - Options Paper on methodology to be adopted for 2022-23 determination

The Energy and Technical Regulation Division (the Division) of the South Australian Department for Energy and Mining thanks you for the opportunity to comment on the Default Market Offer (DMO) prices - Options Paper.

The South Australian Government is committed to reducing consumers' electricity bills and thanks the Australian Energy Regulator (the regulator) for its work in considering an appropriate methodology for adopting in the 2022/23 determination and beyond.

The Division supports the regulator continuing to adopt an indexation approach, given that the policy objectives appear to have been largely met under this approach. Continuing to adopt this general approach also provides a level of predictability and should avoid marked price changes for customers as could occur if a bottom-up approach was adopted after the initial three years of the policy. Maintaining a known approach is likely to provide a certain level of consistency and certainty for stakeholders which should not be underestimated in the current climate.

We do note that the initial DMO price was set using market offers from October 2018. By adjusting the residual amount to reflect more recent changes in retail costs using data supplied in the ACCC's 2020/21 market monitoring report, as suggested under option 3, may provide additional benefits over the current indexation approach (option 2).

It would enable a more transparent adjustment to be made to the residual amount in each DMO annual determination and, if retailers have made productivity gains over time, then a reduction in the residual amount may be possible. As noted in the options paper, this would unlikely be the case under the current indexation approach. The Division therefore supports further consideration of option 3, the annual residual adjustment approach, if the benefits over the current approach outweigh any potential risks.

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The Division considers that option 1, the bottom-up approach, is not an appropriate method to determine the DMO for the coming period. While the bottom-up approach is normally the chosen method to determine efficient costs, the DMO is not intended to be the lowest offer in the market and therefore this approach is not supported as it may result in unintended consequences for retail competition.

If this option is adopted, we note that applying a consistent retailer margin allowance across DMO regions could possibly result in allowances for retailer margins in South Australia increasing, given the examples provided in the options paper. We note the regulator's view that if setting a consistent margin resulted in a higher DMO price, there is no requirement for retailers to increase standing offer prices to that level given the DMO is a 'maximum' price. The Division considers that retailers do traditionally set their standing offer prices consistent with the level of the DMO, so any increase in retailer margins would likely have an impact.

With regard to the appropriate duration for the methodology to remain in place without substantial amendment, while the Division supports any changes to the methodology remaining in place for a reasonable period to provide consistency and certainty, it supports a three-year duration as opposed to a five-year period. This would align with the availability of ACCC retail reports (and avoid the need for an alternative approach being used for the final two years to estimate retail costs).

On other matters raised in the options paper, the Division concurs with the views of the regulator in that the overarching 'market based' approach to forecasting wholesale costs adopted in previous DMO determinations remains the most appropriate for future determinations. We also note the regulator's further consideration of the appropriate hedge book build period that should apply. While a shorter book build (as proposed under chapter 5, option 2), would ensure DMO forecasts are more reflective of current wholesale price expectations, it would result in a change from the regulator's current approach and therefore reduce stability. A longer hedge book build period, as is currently used, also smooths out any price fluctuations and results in less pronounced changes in forecast prices from year to year, as the options paper notes.

With regard to the potential inclusion of time of use (TOU) tariffs in a network cost assessment, while the majority of customers are still on flat tariffs it is expected that the number taking up TOU tariffs will increase over the next few years. In South Australia, SA Power Networks is in the process of reassigning customers with smart meters to TOU network tariffs. This reassignment has an expected completion date of 1 January 2022.

Given the DMO's role as a reference price, the Division agrees that excluding assessment of TOU network tariffs may have an impact on retailer behaviour, potentially leading to them not promoting offers that would encourage switching to TOU tariffs. For these reasons the Division supports the inclusion of TOU network tariffs in the network cost assessment (chapter 7, option 2).

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The Division also supports the inclusion of advanced meter costs in the DMO cost assessment (chapter 8 - option 1). Not fully reflecting these costs in the DMO may act as a disincentive for retailers to roll out advanced meters. If not captured, and as a result if the DMO is set too low, there is the possibility that market offers may increase to account for any material cost changes as these meters are rolled out in greater number in the coming years.

We consider advanced meters are critical tools to mitigate the risks associated with low system demand in South Australia. While supportive of competition in metering, the Division has been disappointed at the speed with which advanced meters have been rolled out to small customers.

Given the current low level of advanced meters in the market, we agree that simply applying the full cost of an advanced meter to the DMO price would be unfair to the large majority of customers without advanced meters. Inclusion on a weighted basis consistent with the proportion of customers with advanced meters in each region, is therefore supported. Given accumulation meter costs are currently included in the network cost component of the DMO, it will also be important for this cost to be removed if advanced meter costs are to be included.

The Division thanks the regulator for the work on this review. Should you have any questions in relation to this submission, please contact Mr Chris Leverington, Senior Policy Officer, Energy and Technical Regulation Division, on (08) 8429 3298.

Yours sincerely

Vince Duffy
EXECUTIVE DIRECTOR
ENERGY AND TECHNICAL REGULATION

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