tango ENERGY

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Retail Electricity Prices review - Determination of default market offer prices 2022-23– Tango Energy submission

Tango Energy thanks the Australian Energy Regulator (AER) for the opportunity to comment on the methodology to be adopted for the 2022-23 default market offer (DMO) determination (and subsequent years) https://www.aer.gov.au/retail-markets/guidelines-reviews/retail-electricity-prices-review-determination-of-default-market-offer-prices-2022-23/initiation#step-78006.

Tango Energy is the wholly owned subsidiary retail arm of Pacific Hydro Australia (PHA). PHA was founded in 1992, and is a leading owner, operator and developer of renewable energy assets. It operates a high quality, diversified portfolio of wind, hydro and solar assets with an installed capacity of 665 MW; it also has a development pipeline of substantial projects totaling over 1100 MW of potential capacity, as well as over 300 MW of energy storage solutions.

We are a relatively new and growing retailer with approximately 130,000 small and large customers as of November 2021. While our customer base is predominantly in Victoria, Tango Energy also recently started selling to small customers in New South Wales, Queensland, and South Australia and expects to grow our presence in those jurisdictions.

Outcomes sought

As stated, the AER's policy objectives are stated on p.10 of the Options Paper as to:

- *reduce unjustifiably high standing offer prices and continue to protect consumers from unreasonable prices;*
- *allow retailers to recover their efficient costs of providing services, including a reasonable retail margin and costs associated with customer acquisition and retention; and*
- *enable competition, innovation and investment by retailers, and retain incentives for consumers to engage in the market.*

Furthermore, Tango Energy note the AER also states in response to the policy objectives in relation to previous DMOs (1 to 3):

“We set the DMO at a price where standing offer customers saw price reductions, but where retailers still have incentives to compete on price, invest and innovate with their market offers.”

“In each determination, our analysis has shown the DMO price continued to enable retailers to offer prices that facilitate competition and provide incentives for customers to switch to a market offer.”

As the current methodology appears to be achieving the policy objectives, our view is that strong justification is needed for a material departure from the current indexation DMO methodology used over the last 3 periods. We consider that there is a strong case for retaining the indexation approach (Options 2 and 3 in the Options Paper) and elaborate on our views below.

Considerations of the indexation vs. bottom-up cost stack approach

A bottom-up cost stack requires the regulator to, based on the input of many stakeholders with conflicting priorities, provide inputs into not only what previous costs should be, but what it thinks the future costs should be. This requires a significant amount of assumptions to be made, effectively picking winners and losers along the way in each decision, with a significant risk of “cherry-picking” of data occurring. As the components of the cost stack are built up, the errors and biases inherent in each decision build on each other, creating a significant amount of volatility and statistical errors and bias in the models used. In our opinion, this is a fundamental theoretical flaw of the cost-stack approach that does not apply to the indexation approach.

The indexation approach appears to be more well-aligned with economic principles of price setting within a competitive retail market, allowing sufficient flexibility in balancing incentives to compete on price, investment and innovation in new market offers, while also controlling the level of price increases in line with wider macroeconomic factors. The indexation approach also allows the AER to take into account shifts and correlation within the cost stack (for example, the cost of marketing may have decreased, but the cost of legal fees may have increased, and the two factors may be closely correlated due to newly imposed regulatory restrictions on marketing practices, resulting in some net effect, either positive or negative) without going into an overly burdensome level of granularity and administrative detail.

Furthermore, the indexation approach allows “lumpy”, one-off costs to be recovered over multiple periods without introducing unnecessary volatility in the level of the DMO through the operation of the current step change framework. The AER stated in DMO 3 (2021-22) with respect to a material change warranting an adjustment through the step change framework that “*We regard a material change is one that would prevent the DMO price from achieving all the policy objectives.”*[1]. In applying the step change framework in DMO 3, the AER set a high bar to justifying step change increases to retailers costs[2], excluding COVID-19 related costs (despite the Statement of

[1] p.55 https://www.aer.gov.au/system/files/AER%20-%20Default%20Market%20Offer%20-%20Price%20determination%202021-22%20Final%20Determination%20-%2027%20April%202021.pdf

[2] Ibid, p40-61

Expectations being in force for most of 2020 and 2021) and one-off significant regulatory change costs related to Five-Minute Settlement and Consumer Data Right, amongst others. Similarly, it can be expected that consistency in the step change framework should be applied to the consideration of downward revisions in retailers' operating costs, with a similar level of justification being needed to justify that there has been a permanent shift in the cost-to-serve, that is caused by an exogenous factor that results in a permanent and prolonged effect. We consider that this further highlights another flaw of the bottom-up approach, as it would require constant adjustments to reflect one-off, year-on-year fluctuations in costs, and would not only build in the biases of the cost stack (as discussed above), but would also be administratively burdensome.

Conclusion

Overall, Tango Energy considers that the indexation approach is superior to the bottom-up cost stack approach, both as an economic regulation tool, and in being aligned with the policy objectives of the DMO.

Tango Energy's preference is for the AER to continue indexation of the DMO residual (either Option 2 or 3). If option 2 (retaining the step change framework) is chosen, ensuring consistent application of the step change framework should be a priority. We are also open to option 3 of using an indexation approach, and adjusting the residual to reflect changes in costs using ACCC data. If option 3 is chosen, then care must be taken to avoid the pitfalls and potential biases of the cost-stack approach discussed above in collecting and interpreting data.

Overall, Tango Energy considers that the indexation approach can continue to strike an appropriate balance between the various DMO policy objectives. We consider that the issues encountered in applying the bottom-up cost stack approach would tend to hinder the meeting of policy objectives of the DMO.

If you would like to discuss this submission please contact me at the details provided with the submission.

Yours sincerely,

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