

Mark Feather
General Manager, Policy and Performance
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submitted by email to: DMO@aer.gov.au

10 March 2020

Dear Mr Feather,

Draft Determination: Default Market Offer Price 2020-2021

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Australian Energy Regulator's ('AER') Draft Determination on the *Default Market Offer Prices 2020-21* ('DMO2').

The AEC is the industry body representing 23 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

Given our position as a representative of competitor businesses, the AEC operates in strict compliance with the Competition and Consumer Act (the 'CCA'). The CCA prohibits the AEC discussing with members confidential information relating to costs and how they set their prices. This submission has been drafted in line with our CCA obligations, and will focus on best practice price regulation methodologies, rather than the preferred methodologies of individual members. Our members will provide more detailed views on any individual issues they may have with the Draft Determination.

The AEC supports the proposed index approach as the most appropriate methodology for setting DMO2 in a manner consistent with the three policy objectives. It provides an adequate safety net for disengaged customers while still encouraging retail innovation and customer participation in the market. In future determinations, we encourage the AER to maintain its stated emphasis for the DMO to be a 'fallback for those who are not engaged in the market and should not be a low-priced alternative to a market offer'.¹

The AEC has provided some high-level comments on the network and environmental cost components to ensure the final DMO is truly representative of retailer costs.

Calculation of network costs

The ACCC's *Retail Electricity Pricing Inquiry (REPI)* found that network costs make up about 48 percent of a residential electricity bill.² The REPI goes on to explain that network costs represent the largest component of an electricity bill and have been the primary driver of higher bills over the past decade.³ It is critical then that network costs are calculated as accurately as possible when setting the DMO. If network costs are undervalued, it will reduce the incentives for customers to engage in the market.

In our submission to the Position Paper, the AEC put forward some revised approaches to setting network costs that might help ameliorate the timing issues the AER is facing. The AER has opted to

¹ Australian Energy Regulator, 'Draft Determination: Default Market Offer Prices 2020-2021', February 2020, p29.

² Australian Competition & Consumer Commission, 'Retail Electricity Pricing Inquiry', 2017, Commonwealth of Australia, p6.

³ Ibid. The decade studied was 2007-2008 to 2015-2016.

follow its own approach in the Draft Determination, being to use the annual change in revenue in the determinations to calculate network costs in south-east Queensland and South Australia. We note that this forecasting method resulted in an underestimation of network costs in South Australia in DMO1. While the AEC's preference remains for the adoption of alternative forecasting methods, such as consulting with network businesses to determine charges, we recognise this is not currently the position of the AER.

In line with the AER's Draft Determination approach and to avoid a repeat of what happened in South Australia, the AEC would support the AER either indexing the revised proposed network costs or allowing for a network price risk allowance in DMO2 calculations. This would allow retailers to recover any undervaluing and ensure continued customer engagement in the market.

Regarding the extension of the DMO to cover time of use (TOU) tariffs, the AEC encourages the AER to undertake analysis to regularly monitor whether TOU tariffs for the representative customer are consistent with flat tariff network costs. For example, in New South Wales, there is a trend towards closing off flat tariffs to new connections and assigning a demand tariff to customers with a smart meter installed. It may be necessary in future determinations for the AER to take into account the annual cost of digital meters. The Queensland Competition Authority's 2019 publication serves as a useful guide for this, as it highlights the annual costs of advanced digital meters that retailers incur and notes these costs are unlikely to materially decline.⁴ If a divergence starts to emerge, the DMO should be adjusted accordingly. Retailers should not be expected to cover for any variation in network costs between the two tariffs, as this would be inconsistent with the DMO policy objectives.

Environmental costs

The AEC notes that ACIL Allen have maintained a market-based approach to calculating retailer costs associated with large-scale generation certificates (LGCs). While we recognise that ACIL Allen sees difficulties in using a contract-based approach, this would better capture the true costs of a representative retailer because it reflects the fact that many retailers procure LGCs through long-term Power Purchase Agreements. Given this will be a recurring problem for future DMO settings, the AEC would welcome an opportunity to discuss with the AER what the most appropriate methodology is going forward.

As acknowledged in the AER's DMO Draft Determination webinar on 2 March and in ACIL Allen's report, non-binding STP values do not properly capture the final binding STPs and are leading to estimates that 'are likely to be too low'.⁵ The AEC supports ACIL Allen's decision to provide its own STP estimates for 2020 and 2021.

Any questions about this submission should be addressed to Rhys Thomas, by email to Rhys.Thomas@energycouncil.com.au or by telephone on (03) 9205 3111.

Yours sincerely,



Ben Barnes
Director, Retail Policy
Australian Energy Council

⁴ ACIL Allen Consulting, 'Costs and Benefits of Advanced Digital Meters', September 2019, p15-16, as cited in Queensland Competition Authority, 'Benefits of advanced digital metering', September 2019, p7.

⁵ ACIL Allen Consulting, 'Default Market Offer: Estimating Wholesale Energy and Environmental Costs', February 2020, p17.