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Sent via email: [DMO@aer.gov.au](mailto:DMO@aer.gov.au)

Dear Gavin,

RE: Default Market Offer Prices 2024-25 Issues Paper

### About Shell Energy in Australia

Shell Energy is Shell's renewables and energy solutions business in Australia, helping its customers to decarbonise and reduce their environmental footprint.

Shell Energy delivers business energy solutions and innovation across a portfolio of electricity, gas, environmental products and energy productivity for commercial and industrial customers, while our residential energy retailing business Powershop, acquired in 2022, serves households and small business customers in Australia.

As the second largest electricity provider to commercial and industrial businesses in Australia<sup>1</sup>, Shell Energy offers integrated solutions and market-leading<sup>2</sup> customer satisfaction, built on industry expertise and personalised relationships. The company's generation assets include 662 megawatts of gas-fired peaking power stations in Western Australia and Queensland, supporting the transition to renewables, and the 120-megawatt Gangarri solar energy development in Queensland.

Shell Energy Australia Pty Ltd and its subsidiaries trade as Shell Energy, while Powershop Australia Pty Ltd trades as Powershop. Further information about Shell Energy and our operations can be found on our website [here](#).

### General Comments

Powershop thanks the Australian Energy Regulator ('AER') for the opportunity to provide feedback on the Default Market Offer Prices 2024-25 Issues Paper ('Issues Paper').

We acknowledge that the Australian energy market is undergoing a time of change as we collectively transition towards net zero by 2050 and an emissions reduction target of 43% (on 2005 levels) by 2030. Change is happening on a scale which is affecting consumers and industry alike, creating challenges and changes which did not exist at the time of the first DMO.

It is because of this rate of change within the energy sector that Powershop believes first and foremost that the DMO must remain flexible and adaptable to advances in technology and the associated regulatory instruments seeking to control these. The speed of the transition is growing year upon year, and market instruments such as the DMO must be able to flex and adapt to these changes so that it continues to assist, and not hinder, market

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<sup>1</sup>By load, based on Shell Energy analysis of publicly available data.

<sup>2</sup> Utility Market Intelligence (UMI) survey of large commercial and industrial electricity customers of major electricity retailers, including ERM Power (now known as Shell Energy) by independent research company NTF Group in 2011-2021.

participants as we collectively work towards positive outcomes for consumers and targets set by the Australian government.

Powershop also urges the AER to consider the differences between large and smaller retailers with regards to economies of scale. Tier 1 retailers generally have lower costs to serve within the 'cost-stack' than Tier 2 retailers; therefore, if margins are already tight due to the DMO impacting Tier 1 retailers, then comparatively Tier 2 retailers may be in a significantly more impaired position to make competitive offers to customers. This would negatively impact retail competition for small customers.

The costs of on-going reforms must also be taken into consideration when determining the impact that the DMO may have on retailers. For instance, the AEMC's smart meter rollout, Billing Transparency, the AER's Better Bills Guidelines, Consumer Data Right, and many more reforms all have an impact on the cost to serve. While some of these reforms may be necessary, they do not come without a cost to retailers, and eventually the customer. Powershop is able to provide evidence of these costs to the AER in confidence before the draft determination is released.

Powershop did not support the previous DMO final decision made by the AER. Powershop considered the AER was diverging away from the methodology of its price cap mechanism to drive short term outcomes at the expense of true market conditions, including costs to retailers and ultimately to consumers. We consider it essential that the DMO reflect the realities of the energy market, and that it is not seen as a mechanism to address cost of living pressures, nor should it be positioned as the best offer. There are state government instruments which are better suited to assist with cost of living pressures, that would not distort the retailer returns required to sustain a healthy, competitive industry.

Further, Powershop did not support the ultimately subjective approach taken for retailer margins, a departure from the effective, reasonable allowance glidepath. Powershop also did not agree with the previous hedging decision of DMO 4 that increased financial risks to retailers in the circumstances of high pool price events. Given the volatile 2022 market events, that decision remains contentious today.

The AER is now asking industry to provide further comment and feedback on these issues. It is a welcome opportunity to discuss retailer margins and true retailer costs including wholesale cost methodology, and we hope DMO 6 will deliver upon those items in a manner that aligns with the DMO's original objectives.

Powershop is happy to assist the AER in finding solutions to the issues presented throughout the consultation.

## Powershop Response to Consultation Questions

### Wholesale Costs

#### Question 1

What approach should we take towards estimating load profiles? Should we retain profiles based on the NSLP and CLP, create blended profiles using the NSLP/CLP and advanced meter data, or take another approach towards estimating load profiles? Which is most reflective of a reasonable retailer's approach?

Powershop considers that with the abundance of data and resources available, the AER should be able to utilise these to estimate load profiles. We recommend that a methodology that uses a weighted average of NSLP/CLP and advanced meter data, will provide a truer reflection of wholesale profiles.

Net System Load Profiles ('NSLP') in isolation are not sufficient within the current market due to the heavy penetration of solar into the market, which in part has driven an increase in the proportion of smart meters. For instance, the shape of the Queensland annual demand profile has been subject to significant change over the last few years, due to increased household solar PV generation.

#### Question 2

Is the lack of transparency of AEMO's advanced meter data a major issue for stakeholders? What information could we provide stakeholders to address issues with transparency of data?

Powershop considers that while transparency of data is a concern for stakeholders, a more pressing issue is ensuring the accuracy of data used so that it is reflective of energy markets, wholesale energy costs (WEC), and load profiles and to a standard in which stakeholders can trust. While this may also link to transparency, accuracy is the primary concern. Currently, AEMO's advanced meter data should be seen as objective and transparent as it is managed by AEMO as an independent body.

### Question 3

How should we consider the impact of solar PV exports in advanced meter data when estimating load profiles?

Powershop considers that solar exports could have an impact on load profile estimation and forecasting, including more peakiness and seasonality factors, which needs further investigation through analysis of solar vs non-solar profiles and roll out of solar PV. Powershop considers that in order to determine the impact of solar PV meter data when estimating load profiles, the AER should consider splitting customer profiles of those who have installed solar and those who have not installed. The load profiles for solar customers versus non-solar customers have the potential to be substantially different as there may be a range of factors which influences their unique profiles.

Splitting the profiles could allow the AER to further analyse those differences for the DMO's methodology moving into the future by providing a more accurate view of true cost recoveries.

Powershop also considers that the energy market and consequent load profiles are in a constant state of evolution as Australia transitions to a low emissions future. New infrastructure is constantly being added at customer sites, and demand patterns are changing with new technologies such as EV uptake and associated charging. As projects such as the AEMC's smart meter roll out ramps up, the shape of load profiles and consumer dynamics are going to change significantly over the next few years. While smart meters in particular will improve the accuracy of load profiles, ensuring that the DMO is adaptive to the advances in metering and other CER technologies when estimating load profiles will need to be a significant priority for the AER.

### Question 4

Should the AER determine separate load profiles for residential and small business customers? Is this reflective of a prudent retailer's approach?

Powershop has previously advocated for the separation of load profiles between small residential customers and small business customers to reflect true costs. The Issues Paper states "although there are likely differences in the impact of solar PV systems between these customer types, retailers may take a combined portfolio view for residential and small business customers when determining their hedging strategy"<sup>3</sup>. We consider that it should not be assumed all efficient retailers would take such an approach. There is more data now available to provide the AER the ability to accurately apply small residential profiles separate to that of small business.

Most prominently, Powershop considers that the load profiles should be reflective of true acquisition costs incurred. We query whether there should be two separate methodologies used to determine a DMO for those customers who have upgraded to smart meters and those who have not. This will enable the analysis to account for the transition of the energy system without hindering one group of consumers over another.

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<sup>3</sup> Australian Energy Regulator, Default market offer prices 2024-25 issues paper, page 11

#### Question 5

Should the AER have a singular profile for the entire NSW region instead of individual load profiles based on distribution zone? Is this reflective of a reasonable retailer's approach?

To continue to better reflect the true profile of servicing customers in New South Wales, Powershop believes the AER should continue to split out individual load profiles by distribution area. A singular profile would only hide true costs of those more expensive distribution areas, which could inadvertently benefit some consumers whilst hindering others. Continuing to split out will provide greater cost clarity to the AER and customers.

Powershop considers that a general principle should apply where if there is a divergent cost base and cost drivers within a region then these should be split, as is already the case with network costs. As customer dynamics, demand shape, and cost revenues develop, so too should the DMO methodology in order to accommodate materially divergent cost structures. We appreciate that the AER is presented with a challenge here in weighing the benefits amongst the costs and administrative burden for retailers.

#### Question 6

What additional data should we consider when assessing contract pricing for DMO 6, given the lack of liquidity in South Australia remains?

Powershop considers that the derivative market for NEM regions have varying degrees of liquidity, however, it is widely used as an effective channel for managing risk related to retailing. Retailers without generation assets will use the futures market (listed contracts on the ASX) or the over-the-counter market utilising standard documents to govern derivative contracts between two counterparties. We are concerned that relying on the ASX would present risks as if there are no trades at the end of a trading day, there could be no movement in the market curve.

Some of the over-the-counter contracts are traded directly and others via an intermediary broker (broker). A number of brokers (e.g. GFI, TFS, ICAP) provide daily curves indicating their view of the fair value of contracts at the end of each trading day. This view is based on actual trades for the contracts, relativity of the contract to other contracts in the same region, and the relativity to other regions.

To offset the poor liquidity in a contract or region, we recommend these curves could be used by the AER to produce a more reflective view of contract market activity. For example, the prices for relevant contracts in a broker curve for a region with poor liquidity could be matched to the actual futures volumes in a neighbouring region to derive the DMO.

#### Question 8

Should we consider any other changes to the wholesale cost methodology in light of a changing wholesale market?

For DMO 5, Powershop submitted that the hedge book build should be a range of 12-24 months rather than the current 3-year period. We still believe this should be the case due to the scale of change which occurs within the current period. Both load and shape change naturally over time, however this has particularly been the case over the last few years due to a range of factors.

Not only has the market experienced significant volatility, but it has also experienced a number of changes in demand and load profiles due to the upscale in CER technologies and other methods of electrification.

Powershop considers that, subject to 5-minute Market Settlements, the wholesale cost methodology should allow for variances in CER technologies, as these portfolios are not able to defend as well from volatile market movements. For instance, using solar as an example, the Clean Energy Regulator develops a rooftop solar projection each year to create the small-scale technology percentage. We query whether

the AER could utilise this information within the methodology to adjust the DMO for solar shapes. This provides another avenue for the AER to collect relevant information, which is independent, produced by a reliable source, and matches what the market already observes for their Small-Scale Renewable Energy Scheme surrender requirements.

## **Retail Costs**

### Question 9

Do you consider these current methodologies used appropriate, and if not, what alternatives should be considered?

The final determination for DMO 5 confirmed that Powershop, and likely other energy retailers who fall outside of Tier 1, incur ongoing expenses that the AER must consider as part of the current DMO process. Particularly, further consideration should be given to review the methodology to provide a forecast of ongoing costs for a retailer to operate in the NECF, and removing biases related to efficiencies based on economies of scale.

It is worth noting that as the energy system transitions, so too do the rules and regulations that govern it. While the reforms which accompany the transition are necessary, they each bring about new costs to retailers which are eventually passed on to consumers. Powershop strongly recommends the AER to consider the cost of reforms within the cost-stack methodology, particularly as there is a reform to accompany nearly all the costs highlighted under section 4.1 of the Issues Paper. For instance, ongoing cost pressures for energy retailers include those to administer changes to compliance, the implementation of the Consumer Data Rights framework, the AER's Better Bills policy and framework, amongst others.

While these costs will be borne by all retailers, larger companies with a greater customer base have more ability to either absorb or distribute these costs. Smaller retailers, however, will have limited capacity to distribute the costs of reform and regulatory change and may either run at a loss or risk competing themselves out of the market.

Powershop will provide the AER with separate, confidential information on our costs.

## **Advanced Meters**

### Question 10

Is the method for cost recovery of advanced metering costs appropriate for DMO 6 and/or future DMO decisions? If not, what alternative methods should the AER investigate to recover the cost of advanced meters?

Powershop considers that using the information received from retailers in relation to advanced metering costs is appropriate, provided that it is accepted by the AER that these costs will keep increasing year on year in light of the energy transition and smart meter review by the AEMC.

We urge the AER to remain adaptable in its regulatory instruments as the costs of the transition increases alongside the relevant technologies which enable it.

### Question 11

Should the AER project advanced meter installations instead of using historic data in future DMO decisions?

Powershop supports projecting advanced meter installations over the use of historic data for future DMO decisions. The use of historic data will put retailers at a material disadvantage given the significant growth in smart meter demand, especially if the current goal is 100% smart meter coverage by 2030. This means that the use of historic data would be redundant as it will become increasingly outdated, particularly in relation to the rate of change expected with the roll out of smart meters.

If the AER were to continue using historic data, Powershop would seek a potential capital allowance be applied.

#### Question 12

What operational or cash flow considerations should the AER consider in determining the cost recovery of advanced metering costs? How do these considerations differ between large and small retailers?

Powershop considers that the size of the retailer is a crucial matter when considering the cost recovery element for advanced metering. Even though all retailers face the same issue, the surrounding costs of smart meters is potentially what sets large and small retailers apart.

Large retailers have a larger customer base, and therefore may be able to secure services from a metering co-ordinator at a cheaper rate because of the abundance of capital able to be secured through the one contract. Whereas smaller retailers may be at a disadvantage in this same scenario as they will need to procure the same work to be done, but on a smaller scale, and so may be subject to either higher fees or limited negotiation abilities because of this.

#### Question 13

What operational and capital expenditure advanced metering costs should the AER include in the costs recovered by retailers? Should these costs be subject to independent audit or review?

Powershop appreciates that the AER is investigating the costs recovered by retailers for advanced metering costs for the purpose of the DMO. We consider that this is an important attribute of the DMO as the cost of recovery will eventually be borne by the consumer, either directly or indirectly.

While we do not have a recommendation on the operational and capital expenditure to be included, we do recommend that when analysing the costs recovered by retailers, it is prudent to review the costs incurred from large and small retailers separately. This will allow the AER to determine whether there are any costs which should be subject to independent audit, as well as providing another avenue in answering Question 12.

### **Retail Allowance**

#### Question 14

Are there methodological changes that would allow us to better balance the objectives in the retail allowance?

Powershop seeks that the AER apply the objectives of the DMO for the maintenance of competition within the market, and to re-establish the glidepath that was applied for DMO 4. There has been no evidence presented in previous DMO determinations to suggest that the glidepath has been ineffective, particularly when the AER has advised it had achieved its objectives for each of the first four editions of the DMO.

Despite other regulated prices with Victoria in particular operating under an efficient margin method, the DMO has additional objectives to sustain competition by allowing retailers to recover their efficient costs, acquire and retain customers, as well as provide an allowance for retailer investment and innovation for customers to benefit further from market engagement. Powershop considers that short term machinations should not put long term market health and competition at risk.

#### Question 15

Should the retail allowance be a fixed dollar amount, and if so, why?

Powershop believes the retail allowance should continue to be a percentage value to reflect an effective glidepath. Powershop believes reflecting a percentage provides for greater consistency and a level of regulatory certainty, allowing for the reasonable margin to be applied to achieve the DMO objectives.

Powershop believes without evidence that a dollar amount would be more effective in covering a reasonable allowance, applying a percentage remains appropriate.

#### Question 16

Alternatively, should the retail allowance be cast as separate components of efficient margin (percentage based) and additional competition allowance? How would these be calculated?

Powershop is concerned that the separation of retail allowance and competition allowance may not factor in other components of innovation and the required investments to compete and innovate. The current retail allowance is approximately 10% however, if the AER were to take a nominal amount of 5% (as per recent competition allowances applied by the QCA and IPART), the overall retail margin would likely remain at a similar level.

#### Question 17

What components are missing from the retail allowance and why?

A glidepath based retail allowance will need to continue to cater for further innovation over multiple years. Powershop will provide confidential information, to the AER ahead of the Draft Determination, on the costs incurred for ensuring we continue to be innovative and invest in products and services our customers want.

### **Other DMO Costs and Considerations**

#### Question 19

Should network costs be based on a blend of flat rate and time of use network tariffs? If so, how should this blend be calculated?

Powershop supports network costs being based on a blend of flat rate and time of use tariffs as this is reflective of actual costs incurred.

We also recommend that the AER ensure that where estimated network costs are applied to this DMO, the estimates are accompanied by an adequate cost recovery allowance within this DMO. This recommendation is in response to the events of DMO 2, wherein the estimated network costs were materially underestimated, and retailers were left to account for those costs.

### **Conclusion**

Powershop understands that the AER is cognisant of the impacts this decision will have on consumers and retailers. The continued issues of the retail allowance and wholesale cost methodology should be carefully considered as per the above feedback.

Powershop reiterates that the DMO is not a mechanism to address cost of living pressures, nor should it be positioned as the best offer. Our responses above instead urge the AER to continue to fulfil the policy objectives set from the beginning. Powershop supports consistency of approach regarding the retail allowance, understanding the environment in which retailers are operating.

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, including the provision of confidential data separate to this submission. If you would like to discuss, please contact Alan Love at [alan.love@powershop.com.au](mailto:alan.love@powershop.com.au).

Yours sincerely



Libby Hawker

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