28 November 2025

Adam Day
a/g Executive Director, Default Market Offer and Consumers
Australian Energy Regulator

Sent via email to: DMO@aer.gov.au

Re: AER's Default Market Offer (DMO) 2026–27 Issues Paper

I refer to your Default Market Offer (DMO) 2026–27 Issues Paper and thank the Australian Energy Regulator (AER) for its consideration of stakeholder views.

1st Energy is a non-integrated, second-tier electricity and gas retailer serving customers across New South Wales, Queensland, South Australia, Tasmania, and Victoria. Since our establishment in 2015, we have been committed to offering competitive energy products in an increasingly complex and evolving market.

We recognise the ongoing cost-of-living pressures facing Australian households and while recent government initiatives have sought to ease financial pressures on households, many Australians continue to face persistent and significant affordability challenges, particularly in essential services such as energy. In this context, the DMO plays a crucial role in protecting customers who do not, or cannot, actively participate in the retail market by ensuring they are charged no more than the efficient cost of supply. As the DMO framework evolves, it is important that this strengthened consumer-protection principle does not unintentionally dampen competition or hinder the viability of smaller retailers, whose presence is vital to a healthy and dynamic energy market. Our submission reflects a commitment to balancing affordability, fairness, and ongoing competitive choice for consumers.

Our response to the matters set out in the AER's paper can be found in Appendix A.

For any queries regarding this submission, please contact Aneta Graham, Head of Regulatory and Compliance, aneta.graham@1stenergy.com.au.

Yours sincerely

Liam Foden
Managing Director
1st Energy Pty Ltd

Appendix A

1. **How should the AER apportion costs across the supply and usage charge elements of the tariff? Is the proposed apportionment of cost elements appropriate?**

We support allocating genuinely variable costs to the usage (c/kWh) charge and recovering fixed, unavoidable costs through the daily supply ($/day) charge. Wholesale energy costs, and most environmental scheme costs, are properly variable and should remain in the usage component, while recovery of fixed obligations (billing platform costs, customer service overheads, regulatory compliance, some network fixed components and the fixed element of market fees) is recommended to sit in the supply charge. This split best preserves cost-reflectivity, reduces cross-subsidy between low and high-consuming customers, and limits price volatility for consumers while allowing retailers to recover the structural fixed costs of supply.

2. **How should the AER determine maximum annual bill amounts? Should they be based on the flat DMO tariffs?**

The maximum annual bill should be based on the relevant network tariff, not on a blended input. This maintains consistency, avoids unnecessary complexity, and ensures customers receive pricing that reflects genuine network cost structures.

3. **Under the proposed Regulations, should the separate flat-rate and time-of-use DMO tariffs use the corresponding network tariff to determine network costs? Why or why not? What alternative approaches should be considered?**

Where the Regulations require separate flat and TOU DMO tariffs, the AER should use the corresponding network tariff structures to determine network costs. Using the actual network tariff maintains direct cost-reflectivity and transparency, ensuring consumers face network charges that mirror the distributor's pricing intent. Alternative approaches (such as blended network inputs) risk obscuring price signals and producing arbitrary outcomes misaligned with actual cost drivers.

4. **Should the AER develop a blended network cost for the maximum annual bill, or should it instead adopt a particular network tariff? Why or why not? What alternative approaches should be considered?**

The AER should adopt the network tariff that corresponds to the regulated DMO tariff (flat or TOU) rather than defaulting to a blended network cost for the maximum annual bill. Blended network costs create opacity and can distort incentives by mixing tariff signals. Retailers themselves create corresponding retail pricing when multiple default network tariffs occur.

5. **Under the current Regulations, should the AER continue to use the flat-rate network tariff or instead develop a blended network tariff to derive network costs?**

Under the current Regulations the AER could continue to use the flat-rate network tariff to derive network costs for the flat DMO. Moving to a blended network tariff is unnecessary unless the policy objective or regulatory scope explicitly requires it. The flat-rate approach keeps methodology simple, predictable, and consistent with previous determinations; any departure to a blended approach should be justified by clear evidence that it better protects customers without sacrificing transparency.

6. **If we were to create a blended cost, how could the issues for small business network tariffs be overcome?**

If the AER were to adopt a blended network cost for small business customers, the AER could segment them into relevant tariff classes, with weighting applied according to actual customer distribution across those tariffs. Published distributor tariff schedules and meter-level data can be used to ensure the blended network cost accurately reflects network charges. Where small business network tariffs are highly heterogeneous, the AER could consider deriving separate representative usage bands rather than using a single blended figure, to avoid cross-subsidies and to protect customers on structurally different tariff types.

7. **Where the corresponding network tariffs are used, and there is more than one default network tariff (for instance in Essential Energy and SA Power Networks), what approach should be used?**

Where more than one default network tariff exists within a distribution area, the AER should create separate DMO price determinations that correspond to each underlying network tariff. As retailers, we already develop distinct standing offer and market plans for each network tariff structure, and cost-reflectivity is only preserved when each tariff is modelled and priced on its own merits.

8. **Which option do you consider best meets the criteria set out above?**

Our preference is Option 1, using the Interval Meter Controlled Load Profile, as it provides the most accurate representation of controlled load usage. Option 2 is also supported where interval meter data is not available. We do not support the use of the Net System Load Profile for controlled load modelling as it does not isolate controlled load behaviour.

9. **What are your views on the application of the new approach to the Energex controlled load profile, in addition to the regions where AEMO's Controlled Load Profile is no longer published?**

We support using interval meter data to define controlled-load profiles, including adopting the Energex controlled-load approach where appropriate. Interval data provides the most accurate reflection of timing and magnitude of controlled loads; where AEMO's controlled-load profile is unavailable, the Energex approach, supplemented by regionally representative interval data and validation checks is a pragmatic alternative.

10. **What are the implications of adopting the 50th percentile WEC estimate instead of the 75th percentile, based on the back-cast analysis?**

We strongly oppose shifting to a 50th percentile WEC estimate. Moving from the 75th to the 50th percentile materially reduces the risk buffer required to manage increasingly volatile wholesale markets. Historical look-back modelling does not capture forward risk.

The 50th percentile approach risks under-recovering costs during volatility events, which can threaten retailer viability. If the AER proceeds with a lower percentile, we are supportive of a volatility allowance to maintain a realistic reflection of wholesale market risk.

11. **What factors should we consider in determining whether a volatility allowance is necessary?**

Key factors include historical wholesale price volatility and frequency of extreme events, contract market liquidity and availability of hedging instruments, forward market signals (e.g., ASX futures), the chosen WEC percentile, and the extent to which other model assumptions (e.g., controlled-load modelling, export

risk) reduce or increase exposure. The allowance should be calibrated to meaningfully cover tail-risk exposures (not routine price variance) and be informed by stress-testing and observed hedging outcomes.

12. Do you agree that the 50th percentile WEC estimate aligns more closely with the proposed requirement to consider the efficient costs to supply small customers?

We do not agree the 50th percentile aligns more closely with considering the efficient costs to supply small customers as it does not by itself capture the efficient cost of supply once prudent risk management and hedging costs are considered. Prudent retailers aim to minimise spot price exposure.

13. What parameters should we consider when deciding whether to include new products in the hedging strategy?

Parameters could include product liquidity, correlation with usage profiles, availability and cost of the product in forward markets, counterparty credit risk, and the product's effectiveness in covering exposure from TOU and export profiles, and operational complexity.

14. Do you agree with the proposed approach to estimating time-of-use WECs? Is there an alternative approach we should consider?

We broadly agree with the AER's direction to model TOU WECs using interval data and contracts that reflect peak demand periods. The AER should ensure the TOU WEC approach uses sufficiently granular interval data and considers export flows and evolving load shapes.

15. How can we best define and calculate the efficient costs to serve for small customers on standing offers?

Efficient cost-to-serve should be defined as the minimum cost required to provide compliant retail services at appropriate quality levels, including billing, customer service, complaints handling, hardship programs, regulatory reporting, and system maintenance. Calculation should use a representative cross-section of retailers (including small and mid-tier retailers), apply cost-driver normalisation for scale and scope differences, and exclude one-off transitional investments except where they are necessary for regulatory compliance. Using a weighted sample rather than only large-retailer averages ensures the allowance reflects market reality.

16. How can we best define and calculate a modest cost to acquire and retain customers?

'Modest' should be interpreted as a measured, evidence-based allowance that recognises necessary onboarding and ongoing service costs but excludes excessive marketing or promotional spending. Small retailers incur higher per-customer acquisition and retention costs because they lack the scale advantages of large incumbents. These costs must be recognised proportionately to avoid disadvantaging newer or smaller market entrants.

In addition, we note that the NERR rule changes designed to improve consumer confidence in the market will, in some circumstances, apply standing-offer pricing constraints and maximum annual bill protections to customers on market contracts. If the Customer Acquisition and Retention Cost (CARC) is set too low, this would create a regulatory inconsistency. Customers who have engaged with the market and selected competitive offers could effectively be subject to protections and pricing limitations designed for disengaged standing-offer customers. This risks diluting the benefits of market participation and blurring

the distinction between standing and market offers. Maintaining an adequate CARC allowance is therefore essential to maintaining both competitive incentives and regulatory coherence as the new NERR reforms take effect.

17. What is the appropriate split of bad debt across fixed and variable components that best reflects the propensity for bad debt to arise?

Bad debt should be split to reflect customer billing behaviour: a substantial portion is usage-linked and should therefore be treated as variable (i.e., higher usage customers generate proportionally higher exposure), while a material fixed element arises from fixed charges and overdue accounts (e.g., unpaid daily supply charges, administration fees). Practically, we recommend the AER estimate bad debt using retailer reported write-offs and provisioning data that disaggregate bad debt drivers, then allocate between usage and fixed components on an evidence basis (e.g., regression on historical write-offs vs usage and account counts). This evidence-based split will better reflect the propensity of bad debt to arise.

18. Based on DCCEEW's proposed reforms, what other alternative approaches should we consider in quantifying the retail margin?

We do not propose alternative margin methodologies at this time; however, we emphasise that any retail margin must remain sufficient to compensate retailers for the real financial risks associated with supplying electricity, particularly wholesale market volatility, compliance obligations, bad debt exposure, and the capital required to operate in the market and operate billing and customer service systems. A margin that is set too low would fail to recognise these risks and could impair retailers' ability to operate sustainably.

19. Would a lower small business margin be more appropriate under the proposed reforms? If so, why?

We do not consider a lower small business margin to be appropriate under the proposed reforms. Small business customers are commercial entities with the same expectation of reliable service and the same capacity to contribute to the cost of supply as residential customers. Reducing the small business margin without, representative evidence would risk undermining the viability of retailers serving this segment. Any material downward adjustment would create a disproportionate impact on smaller retailers, who already face higher per-customer costs and narrower buffers to manage commercial risk. For these reasons, maintaining an appropriate, risk-reflective retail margin across both residential and small business customers remains essential.

20. How should the retail margin be apportioned across the fixed and variable cost components of the DMO?

The retail margin should be apportioned in a way that reflects the nature of risk each cost component bears. A pragmatic approach is to apply a larger share of margin to variable components (such as wholesale exposure) that bear greater volatility and hedging risk, while applying a smaller, steady margin to fixed costs.

21. What, if any, alternative methodologies should we consider in reassessing these retail margins?

We do not propose alternative methodologies for reassessing retail margins.