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Default Market Offer 2026 – 27: Issues paper

Australian Energy Regulator

Submission via email: DMO@aer.gov.au

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AGL Response to Default Market Offer 2026 – 27: Issues Paper

AGL Energy (**AGL**) welcomes the opportunity to comment on the Default Market Offer (**DMO**) 2026 – 27 Issues paper (**Issues paper**).

AGL supports the DMO review recommendation that the objective of the DMO should be to provide a 'fair, trusted and reasonably priced electricity option' for standing offer customers. While this represents a shift from the original DMO framework, in practice the AER has prioritised setting a fair and efficient price without consideration of encouraging competition for several years. The DMO 7 methodology and parameters do not need significant change to continue to set an efficient price that is fair and reasonable.

The regulated DMO tariffs and price caps must ensure that a prudent and efficient retailer is viable – able to meet all costs and provide returns able to attract support the essential debt and equity funding. Retailer viability is essential to deliver good customers outcomes and to ensure the systemic prudential stability of the energy supply system. The energy market is also in the midst of a generational transformation that is changing market dynamics in unpredictable ways and requires retailers to underwrite this significant investment. An efficient DMO will be vital to enable a timely, fair and orderly transition.

Retailers ultimately fund all costs and investment through the energy supply chain, including networks and generation. Retailers are exposed to significant price and volume risks. The DMO sets a regulated fixed price that a retailer must sell electricity at in the future, while all retail costs are variable and, in the case of wholesale electricity costs, extremely volatile. A prudent retailer must ensure it has hedging and funding arrangements in place to manage most credible price outcomes.

Stability, predictability and viability are critical to delivering a fair, trusted and reasonable price for the supply of an essential service. The DMO must be set an efficient price in the long-term interests of consumers.

Recent regulatory changes to the DMO and other retail rules mean that the DMO prices will apply to more customers (including more market customers). The DMO will effectively set prices for a significantly greater proportion of customers in DMO regions. The broader reach of the DMO must be considered when determining the DMO and how it will impact the overall market and long-term interests of consumers. The benefits of innovation and competition are real and can be seen in the increasing diversity of offers and services provided by retailers in the market. Indeed, the DMO review drew on innovation that is only present in competitive electricity markets in making its recommendation to introduce the solar sharer offer.

The 'efficient cost of supply' must balance the myopic pursuit of least cost of supply, with the dynamic efficiencies that the competitive market provides. The competitive market drives retailers to lower the cost of supply through the uptake of new technologies and business practices. The AER should therefore focus on deriving a broadly representative retailer when determining the efficient cost of supply and meeting the DMO objective of a fair and reasonable price. This approach is in the long-term interests of consumers.

Concurrent with this issues paper consultation, Commonwealth DCCEEW is also consulting on the Solar Sharer Offer. When this regulatory reform is finalised, we are mindful that this will introduce another layer of significant regulatory complexity to the DMO. There is no precedent as to how this will be done. The industry must work collaboratively with the AER to achieve an SSO that is viable and doable for retailers and is adequately safeguarded so that it benefits all customers. We look forward to engaging with the AER on the implementation and methodology challenges that the SSO will present in the coming months.

Attached to this letter is our response to the questions raised in the issues paper. Our responses have focused on the proposed changes to the methodology. In summary we

- Broadly support the AER's proposed approach to implementing a DMO tariff.
- Support a simple and transparent approach when considering methodology options, in particular the simplified network cost methodology options identified in the options paper.
- Strongly disagree with the proposal to move from the 75th to the 50th percentile WEC estimate, consistent with the ACIL Allens initial advice to the AER the 95th percentile is appropriate.
- Recommend the DMO methodology avoids the artificial distinction between the efficient cost of supply for standing offer customers when compared with market customers
- Recommend that retailer cost benchmarks should reflect efficient costs of a broadly representative retailer in the market.
- Do not agree that the DMO reforms have significant implications for the quantum and form of retail margins necessary to fund a prudent and viable retailer delivering a fair, efficient and reasonable price for an essential service.

If you have any queries about this submission, please contact Kyle Auret on 0498 003 090 or kauret@agl.com.au.

Yours sincerely,

Ralph Griffiths
General Manager, Policy and Market Regulation

Attachment: AGL Response to 2026 – 27 DMO Issues Paper Questions

Overall changes to the DMO

Question 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?

AGL considers the proposed apportionment of fixed and variable costs of supply to the daily supply charge and usage components of the tariff are appropriate, subject to our preference that the bad debt component of retailer costs remain fixed.

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

AGL supports the AER's preference for the simplest and most transparent approach when calculating the maximum annual DMO price.

We agree that the annualised cost of the DMO flat rate tariff using annual usage amounts is the best option available.

Applying a TOU DMO tariff will introduce unnecessary complexity through the usage patterns and timing estimates needed to derive the annual bill amount.

Network costs

Question 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?

AGL supports the use of the corresponding network tariff type when determining network costs for the flat rate and TOU tariffs.

Whilst the two-year delay in potential retail tariff reassignment will result in a mismatch with flat-rate tariff customers and their network tariff type, it is not clear if this feature will be a material reason for undertaking the more complex methodology of blending network tariffs to derive the network cost component.

At this initial stage, it is possible that overall cost implications for a large retailer with flat-rate customers on a TOU network charge is neutral when compared to flat-rate network costs scenario. Due to the diverse mix of customers, the cost outcome for customers should therefore net out to zero.

We are mindful that this neutral outcome may not occur or be temporary as the customers who benefit from TOU network tariffs opt for a retail TOU tariff ahead of the potential tariff reassignment. In the future, this could mean that the probability distribution of customers better or worse off under a network TOU tariff will become skewed towards customer usage profiles that are worse off. This would result in a higher cost outcome overall, rather than a neutral one.

However, the impact of TOU network tariff customers on the flat-rate network cost component is yet to be realised. We consider the methodology should only change to a

blended approach when customer data reflects this issue and is a material factor when determining network costs for flat rate customers.

Question 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?

Consistent with our response to question 2, AGL considers the benefits of simplicity and transparency outweigh any potential benefits of a more complex methodology to calculating the network cost component of the 'catch-all' price.

We therefore support the use of a flat rate network tariff when calculating the maximum annual price.

Question 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?

Consistent with our response to question 3, we do not consider there is a material reason to develop a blended network tariff to derive network costs for the flat rate DMO price. The AER should continue to apply the flat rate network tariff.

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

Question relates to old regulations. Not applicable.

Question 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?

Given the clear benefits of simplicity and transparency in the DMO methodology, AGL considers that the default TOU network tariff is the most appropriate approach.

In the case of Essential energy distribution zone, whilst the most common TOU tariff is the 'BLNT3AL' tariff, this tariff is now closed to new customers. AGL considers it is better to align the DMO TOU tariff structure with the default tariff structure timings to maintain ongoing cost alignment.

Overtime this should also future proof the DMO methodology, as the default tariff becomes the increasingly prevalent tariff for customers on a standing offer.

In addition to the issues raised in this section, we note that in the case of Ausgrid the default TOU tariff is a demand TOU tariff. In this instance we recommend the AER apply the simple TOU tariff structure for the DMO TOU tariff cap.

Wholesale costs

Question 8: Which option do you consider best meets the criteria set out above?

AGL considers it remains important to incorporate the Controlled Load (CL) accumulation meter load shape when determining the CL WEC component. Whilst CL on interval meters is leading to changes in the daily consumption profile due to network and market price signals, the accumulation meter profiles are largely static. The difference in load

shape will need to reconciled in the representative load shape through the blending these two load shapes.

AGL considers the best approach is to blend the AER's interval meter CL profile with the NSLP (Option 3). This blended approach uses the most recent market data up to date data and ensures the methodology remains suitable for future DMO determinations.

Question 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?

Whilst the AEMO Energex CL profile is still available, AGL supports a consistent approach across all distribution zones and should therefore include Energex in any revised CL profile methodology.

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

A retailer should always undertake a prudent approach when managing wholesale market risks. The regulated price must reflect efficient and prudent costs to ensure the financial viability of the representative 'efficient' retailer. This is essential to ensure systemic prudential stability of the sector. Retailers fund all costs through the energy supply chain, including networks and all generation.

Stability, predictability and viability are critical to delivering a fair, trusted and reasonable price for the supply of an essential service.

The underlying hedging strategy used in the calculation of the WEC leaves some exposure to spot market risk. Such risk can be significant given the unpredictable volatility of electricity wholesale markets and potential for very high wholesale prices (including due to unforeseen or unlikely events). The management of this spot market risk for customers is a critical aspect of electricity retailing. Underestimating the WEC could make it difficult for retailers to achieve modelled cost levels in practice whilst still maintaining a prudent hedge position.

The energy market is in the midst of a generational transformation that is changing market dynamics in unpredictable ways. Huge investment is required in new renewable generation, shaping and firming. Governments and policy makers appropriately emphasise the critical importance of retail contracting practices in providing clear market signals and underwriting generation investment that ensures the right mix of generation investment in the NEM.

The DMO methodology should not undermine this critical objective.

The reduction from the 75th percentile to the 50th percentile WEC estimate is not reasonable or a reflection of efficient and prudent retailer costs of supply in a highly volatile market. We remain strongly of the view that the WEC estimate should reflect the 95th percentile of modelled WEC outcomes.
The rationale for the 95th percentile is increasing with time, not diminishing. The NEM is transitioning to a near fully renewable system that will be more complex and volatile, requiring new contracting and hedging strategies across bulk energy, shaping and firming services. The DMO should allow and encourage an efficient retailer to prudently manage

exposure across the broad range of spot market outcomes. This is particularly essential to ensure the wholesale market provides all the services that consumers need.

The AER's consultants, ACIL Allen, have consistently stated their WEC model estimate inherently involves a degree of uncertainty. Adopting a high percentile estimate from the simulations as the final estimate of the WEC minimises the risk of underestimating the true value of the WEC. In the 2024-25 DMO consultant report, the report states:

> *Further, adopting a higher percentile recognises the varying degree of price uncertainty between the different regions and load profiles. Whereas, adopting the 50th percentile, as an extreme example, in effect assumes the same degree of uncertainty for all regions and load profiles, which is not the case.*

The report then goes on to note that whilst the VDO applies the 50th percentile WEC there is an additional volatility allowance which is analogous to moving the 50th percentile WEC to a higher percentile.

The issues paper characterises the 50th percentile estimate as the median forecast outcome and therefore would compensate retailers for the expected costs of hedging. However, the 50th percentile is not evenly distributing forecast risk between electricity retailers and customers. The risk is asymmetric to the downside for the retailer in the modelled spot price outcomes above the 50th percentile. To treat this data point as the mean would be a mischaracterisation of the risk profile and an inefficient assessment of risk.

Over a sufficient time horizon, a 50th percentile outcome would mean that for one in two years a retailer would not recover its wholesale cost of supply.

Furthermore, the issues paper states that the 75th percentile results in compensating retailers for more volatile than expected outcomes which is an additional risk premium on top of efficient costs of supply. However, for the reasons outlined above we consider, a prudent and efficient retailer would reflect the additional spot price risk faced in potential outcomes above the 50th percentile. The DMO sets a fixed price that a retailer must sell electricity in the future, wholesale electricity is the most volatile commodity in the world and it a prudent should ensure it has hedging and funding arrangements in place to manage most credible price outcomes.

Coin toss odds are not prudent and are certainly not appropriate for regulated pricing of an essential service.

We consider the AER has gone beyond the supplementary report[1] findings in reaching the conclusion that the 50th percentile is a reasonable option.

The AER has drawn this conclusion in light of the back-test of the actual load and spot prices. Drawing such a conclusion using hindsight of a limited information set and single

[1] Assessing the performance of the wholesale cost model, Supplementary report for the DMO 8 issues paper, AER, Nov 2025

outcome is not appropriate. The AER's conclusion is also inconsistent with the conclusion of the supplementary report which states:

> *"While the model has not always predicted future outcomes, there is no evidence of systemic underestimation or overestimation"*

Any limitations of the WEC model must be appropriately explored and tested with the WEC consultants, ACIL Allen. We encourage the AER to engage with the consultants reasoning for why the 95th percentile approach is considered appropriate under the QCA pricing determinations. As noted above the supplementary report is too limited to result in a change in DMO methodology.

ACIL Allen has presented the rationale for adopting the 95th percentile simulated WEC in its methodology papers for DMO 2 and 3. Estimating the WEC inherently involves a degree of uncertainty. Adopting a high percentile estimate from the simulations as the final estimate of the WEC minimises the risk of underestimating the true value of the WEC – noting the DMO is a form of price cap. It also recognises that the risk inherently sits with retailers

Question 11: What factors should we consider in determining whether a volatility allowance is necessary?

We note the AER is considering the option of a volatility allowance if WEC methodology changes to the 50th percentile estimate. As stated in our response to the previous question, the 50th percentile approach will result in an under-recovery of costs when high volatility periods occur.

Therefore, whilst a volatility allowance recognises the additional risk faced by the representative retailer if the 50th percentile approach is applied, this is not the best option when compared with a representative retailer forecasting the 95th percentile of modelled WEC outcomes.

However, in the event that the sub-optimal 50th percentile approach is applied, the DMO must recognise the additional financial risk faced by retailers and the necessary cost associated with having access to necessary funds to remain solvent. The volatility allowance at least in part recognises this additional retailer risk. We therefore support the AER at least applying the ESC's VDO methodology to determine a volatility allowance.

Question 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?

The 50th percentile WEC estimate does not reflect a retailer's efficient costs of supply. The reasons are outlined in our response to question 10

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

We agree with the AER's position not to include the new products outlined in the issues paper. Trading volumes and frequency of trading should be key factors in the AER's determination in future years of whether to include those contracts in the assessment of WEC for those future years.

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

We note that the AER's proposal to derive a TOU WEC uses the overall WEC and then applies the ratio of the demand-weighted price in that period to the overall demand weighted price (DWP) for the profile. As noted in the issues paper, this is similar to the QCA approach and assumes that the ratio of the WEC to DWP is the same for all periods. Whilst this approach assumes the same customer shape for TOU customers as flat rate customers, we consider this approach is reasonable and avoids unnecessary complexity to the methodology.

Retail and other costs

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

Maintaining the current approach to applying the customer-weighted average costs to serve of all retailers (Option 2) is our preferred option for the reasons outlined below.

As outlined in the Issues paper, the AER will need reassess the retailer cost methodology in light of the proposed changes to the DMO regulations. The changes will specify that the efficient costs of supply for small customers relate to standing offer customers and the DMO objective of a fair, trusted and reasonable price.

The AER should consider all customers and retailers in assessing efficient cost to serve. Whilst the cost assessment must focus on standing offer customers it is an artificial distinction and regulatory construct to derive separate cost benchmarks for standing offer customers as though entirely separate to market customers. All aspects of a retailer exist as one entity that services a variety of customer types with market incentives driving cost efficiencies that further lower the cost of supply. Investment in technology will continue transform the quality of service retailers provide to all customers.

As evident in the options explored in both the retailer cost to serve, and the cost to acquire and retain customers, the AER has a preference to move to standing offer customer weighted average cost assessments. This results in large retailers in the market setting the cost benchmark. The 'efficient cost of supply' must balance the productive efficiencies, or the pursuit of least cost of supply, with the dynamic efficiencies that the competitive market provides. The competitive market drives retailers to lower the cost of supply through the uptake of new technologies and business practices. The AER should therefore focus on deriving a broadly representative retailer when determining the efficient cost of supply and meeting the DMO objective of a fair and reasonable price. This approach is in the long-term interests of consumers.

Any retailer cost benchmark should therefore recognise the role of all retailers in this market in driving long-term cost efficiencies. Without this, retailers unable to achieve least

cost benchmarks will exit the market, therefore lifting competitive market pressures to lower costs of supply for all retailers. Remaining retailers will then not invest in new technologies and operational changes to lower their costs because they do not have to.

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

Whilst not included as an option we consider the same weighted average approach to cost to serve should also be applied for the CARC benchmark.

The AER can then exercise their discretion when removing retailer cost outliers to ensure the benchmark reflects a modest cost that achieves the DMO objective of a fair and reasonable price.

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

AGL does not consider there is a strong basis for moving to a variable or hybrid approach (fixed and variable) when setting the bad debt costs in the DMO tariff. This is because we do not consider there is a strong correlation between the existence of bad debt and the consumption amount.

Consistent with other regulators, the AER should continue to apply bad debt as a fixed amount per customer. This approach has the added benefit of simplicity and consistency in cost recovery when compared with other market customers.

Retail margin

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

There is no rationale or requirement to reassess the quantum or level of retail margins for the DMO as a result of the change in DMO objective.

As highlighted in our previous submission to the 2025 – 26 DMO consultation, actual retailer margins are at historic lows. The compounding market impact of recent regulatory and DMO methodology changes are yet to be appropriately observed and considered.

The AER has identified the Frontier Economics reports for the ESC (2019) and the ACT ICRC (2024) as important references when undertaking this review. Whilst useful, the reports' conclusions and recommendations must be interpreted correctly. For the reasons set out below, the AER must consider the relevant economic and market variables that support a particular margin estimate scenario. The AER should therefore only reference the most relevant scenario when taking this report into account, rather than simply considering the range.

Expected returns approach – Frontier analysis

The expected returns methodology involves establishing a Weighted Average Cost of Capital (WACC) for a representative retailer, then modelling the likely returns of the

representative retailer and exogenous market factors that will impact retailer returns. These modelled outputs are then used to determine the implied systemic risk and therefore determine the efficient retail margin.

There are a number of variables used to estimate each input parameter used to determine the efficient margin. To reflect the various states of the world, three scenarios are modelled: low, base and high. Each reflecting a low to high estimate of key inputs such as the WACC, market volatility, electricity demand volatility.

In the case of the 2024 Frontier updated analysis this leads to the scenario margin of 4.5% (low), 5.2% (base) and 5.9% (high). Importantly this is not a modelled margin range of 4.5% to 5.9% that reflects an efficient retail margin in all circumstances.

As noted in the issues paper, a key challenge in this approach is determining the set of parameters that should be used. Frontier's analysis should only support the AER's decision where observed economic and market conditions support the modelled input parameters for any of the three modelled scenarios.

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

As set out in the issues paper, the AER consider that it may be appropriate for efficient small business margins under the proposed reforms to be a lower value than the 11% reasonable margin used in prior DMOs.

We support the principle that an efficient margin should only compensate retailers for risk not accounted for elsewhere in the regulated price. In our view the regulatory pricing methodology is unable to capture the inherent risk arising from uncertainty in energy usage due to the wide variation in small business customer types and usage patterns.

Through the course of constructing the representative load shape and daily usage profile, the DMO methodology must make pragmatic compromises to construct a single representative profile. Whilst actual residential load profiles will largely reflect these profiles, actual small business profiles will vary considerably particularly for daily usage profiles. SME customers are less homogeneous.

This volatility in the underlying assumptions has flow on implications for each cost-stack component. The wide variation in SME customer types and usage profiles increases the risk that these assumptions are imprecise, which in turn creates risk at the DMO price level is incorrect for a particular small business usage type. SME customer load is also likely to be significantly more impacted by the economic business cycle, further increasing the risks associated with serving SME customers.

Consistent with Frontier's expected returns approach, economic conditions will also have an impact on the risk profile of small business customers. We consider economic conditions will have an even greater impact on small business usage patterns, when compared to residential customers, due to the stronger correlation with business cycles and the energy needed to run their business.

For these reasons AGL considers the small business retail margin should remain at 11% and must be higher than the residential margin.

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

AGL recommends the AER continue to apply a retail margin as a percentage of total DMO costs.

We support the reasons for this approach as outlined in the issues paper. This simple and transparent approach is well established as regulatory best practice in several jurisdictions, including Victoria. The percentage approach naturally aligns risk and return as cost base and customer load increases and decreases.

The alternative option is the hybrid approach, whereby a portion of the retail margin is applied as a fixed dollar amount and indexed with CPI over time, while the remainder is applied as a percentage to the cost components.

Whilst this approach aims to avoid the retail margin amplifying changes in the cost stack (both increases and decreases), this effect will provide minimal benefit in smoothing changes in the DMO price from year to year. We therefore do not consider the benefits outweigh the added complexity this hybrid approach will introduce.