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Australian Energy Regulator
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**Default Market Offer 2026-27 – Issues Paper**

Alinta Energy welcomes the opportunity to respond to the Australian Energy Regulator's issues paper on the Default Market Offer for 2026-27 (DMO8).

The issues paper incorporates the recommendations made by the Department of Climate Change, Energy, the Environment and Water in their Default Market Offer Review Outcomes paper. We understand these recommendations have informed the matters raised in the issues paper and some are conditional on changes being made to the Competition and Consumer (Industry Code – Electricity Retail) Regulations 2019 (the Regulations).

The DMO has changed substantially since it was first introduced in 2019. The once light-handed approach to price oversight has evolved into a framework that could only be described as formal price regulation. The bottom-up approach, continued reductions in retail margins and wholesale market cost allowances has resulted in a regulated price regime that will further limit customer choice, reduce incentives for retailer innovation and further impact competition in regulated jurisdictions. While we do not support the Victorian Default Offer as a retail price regulation mechanism or its approach to cost allowances, we note that its design and application have remained relatively stable over a number of years. This stability has provided greater certainty for electricity retail market participants compared with the DMO.

The recent recommendations from the review undertaken by the Department will compound these challenges to competition and consumer choice.

Alinta Energy recognises that the AER is bound to regulate the DMO based on the requirements of the Regulations but would urge it to apply its discretion where possible to support competitive market outcomes and mitigate the risk of higher long-term costs or reduced choice for consumers.

The changes to the DMO we are most concerned with are discussed below.

## 1. Solar Sharer Offer (SSO)

Notwithstanding the separate consultation the Department is undertaking in relation to the SSO, we consider that this policy intervention will generate material challenges for the AER to determine and retailers to implement and manage on an ongoing basis.

<u>The SSO will impact similar market offers currently available</u>

Some retailers have already introduced similar offers to the SSO. In the absence of any identified market failure, imposing an AER-determined SSO risks crowding out retailer innovation and reducing the scope for differentiated products that support customer choice.

The SSO needs to be revenue neutral relative to the DMO

As an alternative to the DMO, the overall cost of the SSO must be at least equal to the DMO. This will require the AER to make a number of assumptions about consumer response to the zero-cost window and set a tariff outside of the zero-cost period that recovers network use of system charges, market fees and environmental costs. If the SSO is not cost-neutral, retailers would need to recover unrecovered costs from market-contract customers who are not on the product, creating an unintended cross-subsidy.

Implementation challenges

If changes to the Regulations are made and the SSO is introduced, it is unlikely that retailers will be able to implement the required system, process and customer-communication changes by July 2026. The parameters of the SSO, including how the AER will regulate its price, how it will be presented to customers and how it will be compared with other offers, remain unknown and are unlikely to be settled before early 2026. This leaves retailers with very limited time to implement the proposal in line with DMO8.

We appreciate that the AER is working closely with the Department but cannot proceed with changes to the DMO or define the SSO requirements ahead of regulatory amendments. A rushed implementation risks poor customer experience, regulatory non-compliance and undermining confidence in the SSO as an alternative to the DMO or other market offers. To mitigate these risks, a staged approach should be adopted, with any new, or changes to existing, information-disclosure obligations deferred until retailers have sufficient time and clarity to implement them effectively. Note that retailers cannot commence the necessary, lengthy system changes until the final Regulations are made and there is absolute certainty about the final form of the SSO.

Operational challenges

Further consultation will be required on the information-disclosure requirements to be placed on retailers. Page 29 of the DMO Outcomes Paper suggests obligations that go well beyond current practice and, on some readings, may imply bespoke advice for individual customers; something that is neither feasible nor consistent with how retailers can reasonably operate. Whether a customer would be better off on the SSO depends on their individual behavioural response, making personalised advice impractical and costly. Imposing such requirements would create a substantial regulatory burden and ultimately increase costs for all consumers. As noted above, these obligations cannot be delivered for the commencement of DMO8 and will require a staged approach.

## 2. Wholesale Energy Costs

We do not support reducing the wholesale cost allowance from the 75$^{th}$ to the 50th percentile or the claim that this delivers a “better balance” of risk. Wholesale prices in the NEM do not follow a symmetric distribution; the 75th percentile captures the tail-risk exposure of extreme price events and reflects the level of cover a responsible retailer must maintain to avoid severe, unrecoverable losses when those events occur. By contrast, the 50th percentile simply represents the median modelled outcome. It does not account for the one-sided, non-linear nature of wholesale exposure.

Similarly, the AER’s back-cast analysis showing that the 50$^{th}$ percentile would have covered costs in most years does not justify its adoption. It actually demonstrates that the 50$^{th}$ percentile would not have covered costs in some years, highlighting its inadequacy; those are precisely the years that justify a higher-percentile allowance. And critically, it does not address the inherent volatility risk that retailers must still manage across all years, as evidenced by the years in which wholesale costs exceeded that level.

The AER has already removed the competition allowance and reduced retail cost allowances. Lowering the wholesale percentile as well would compound the erosion of cost recovery, increasing the likelihood of under-recovery during high-price periods and weakening the financial resilience needed to support sustainable market conditions in the long-term interests of consumers.

We also note this element of the DMO has been subject to continual change, reducing retailer certainty

(from indexation, to applying the 95th percentile, then the 75th percentile and now a proposal to apply the 50th percentile).

If the AER does decide to adopt the 50th percentile, a volatility allowance should be applied. Relying on historic spot market outcomes as the basis for once again changing the percentile for the WEC estimate does not reflect the risks borne by retailers to hedge the demand profiles in DMO jurisdictions.

### 3. An "efficient" retail margin and the form of the margin

The recommended reform to base the DMO on the "efficient costs of supplying electricity to small customers on standing offers" does not justify altering the current rate-of-return approach, because that allowance is itself an efficient cost of supply. The existing return-on-risk methodology reflects the real and unavoidable costs retailers incur in managing wholesale volatility, funding working capital, meeting compliance obligations and serving higher-cost standing-offer customers; genuine components of an efficient cost stack. Maintaining the current margin is therefore fully consistent with the requirement to use efficient costs, whereas reducing it would understate those costs, distort the benchmark role of the DMO and risk undermining the commercial viability of supplying standing-offer customers.

If an alternative approach is adopted, we strongly recommend the AER:

- Use sources of data that can be relied upon to establish a holistic view of the retail margin; and
- If advertised market offers are used as a data source, payback periods need to be included, given retailers often do not make margin in the first one to two years on market offers.

We also recommend that the AER apply the margin to the cost stack as a percentage as it has in the past. This provides retailers with certainty over the return on operating a retail energy business and reflects movements in the cost stack over time. We do not support a hybrid approach as it may be subject to frequent change and rebalancing between fixed and variable components, reducing certainty which has been the case for other elements of the DMO.

With respect to supplying small business customers, a higher retail margin for small business customers is justified because supplying them involves greater risk, higher cost-to-serve and more complex load profiles than supplying residential customers. Small business consumption is typically less predictable and more sensitive to price, increasing the level of commercial and financial risk retailers must manage. Their loads are also more concentrated during peak periods, which drives higher hedging costs and greater exposure to adverse market conditions. In addition, small business customers often require more intensive customer service, credit management and billing support, and have a higher incidence of payment risk than residential customers. These factors mean the efficient cost of supplying small businesses is inherently higher, and the margin must reflect that higher risk profile to ensure sustainable and efficient service provision.

### 4. DMO as comparison price

The Department's recommendation to reframe the DMO as a comparison price, rather than a reference price, represents a material departure from its current purpose. Retailers would be required to compare market offers with similar tariff structures to the corresponding DMO rate. This change would place significant resource demands on retailers, requiring updates to pricing and billing systems, revised customer communications and collateral, and additional training for contact-centre staff.
We do not believe the timing of the final Regulations and any guidance from the AER will allow enough lead-time to prepare for this change to be in place by mid-2026. A rushed implementation risks poor customer experience, costly rework and potential non-compliance for retailers. We would urge the AER to consider the existing regulatory change pipeline and the significant resource burden this has placed on energy retailers.

### 5. Customer acquisition and retention costs

The AER has been asked to consider only 'modest' customer acquisition and retention costs for DMO8. Retailers do not separately allocate costs between standing-offer and market-offer customers, and CAR activities benefit standing-offer customers by enabling them to move to a better market offer, for example, in response to advertising or other engagement activities funded through the CARC.

We agree that applying the cost to acquire and retain of the largest three retailers would result in a more 'modest' level of CARC than was approved for DMO7. While still under-recovering costs, this option would be preferable to the Essential Services Commission's approach that arbitrarily applies a benchmark to costs to acquire and retain in the NEM – data that is over ten years' old and simply indexed to inflation.

Regardless of the approach the AER adopts following from the Department's recommendations, the cost to acquire and retain customers will not reflect those of smaller retailers. Ultimately, this will impact choice for all consumers, reducing the likelihood that standing offer customers supplied by the biggest three retailers will have the opportunity to take up market offers with smaller retailers.

We respond to the AER's consultation questions below. Alinta Energy welcomes any further opportunity to discuss our response with the Commission. Please contact David Calder (David.Calder@alintaenergy.com.au) in the first instance.

Yours sincerely

**Graeme Hamilton**
General Manager, Regulatory & Government Affairs

**Questions for feedback – to be added 25/11**

**Chapter 3: 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?

In general, we support the suggested apportionment of costs between fixed and variable components as shown in figure 3.1 of the issues paper to arrive at a tariff basis for the DMO.

There are some exceptions to this, where costs have both fixed and variable components, including network tariffs, bad debt and the fixed and variable market (AEMO) fees.

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

A flat DMO tariff would be the simplest approach to determine the maximum bill amount. While variations in some non-standard cost reflective tariffs may deviate from the calculated maximum annual bill, this approach would be simple to manage and supports consistency across regions to which the DMO applies.

**Chapter 4: Network costs**

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

The corresponding flat and time of use network tariff applying to their DMO counterparts should be used to determine network costs. This would align more closely with the actual network costs incurred and with the approach applied in Victoria. Blending network tariffs inevitably results in cross subsidies. This reinforces the broader point that networks should be obliged to have a network tariff with the same structure as the SSO so that retailers are not required to carry network tariff risk.

**Question 4:** Should the AER develop a blended network costs 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 above, a flat network tariff should be applied to determine the network cost component of the maximum annual bill. This would maintain consistency with the approach where corresponding DMO and market contract tariff structures are not available and give rise to applying a maximum annual bill.

**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?

The AER should continue using a flat rather than a blended network tariff under the current and proposed Regulations to determine the maximum annual bill. Using a blended network tariff would be inconsistent with a maximum annual bill based on a flat retail tariff and adds unnecessary complexity.

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

We do not support blending of network tariffs where an equivalent DMO retail tariff structure is cannot be matched to a corresponding network tariff. It would be preferable to maintain the application of a flat network tariff.

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

For DMO8, we support the adoption of the most commonly available network tariff for Essential Energy and SA power Networks. With solar soaker network tariff structures, it is unclear how effective weighting and blending could be achieved and again, adds unnecessary complexity.

## Chapter 5: Wholesale costs

### *5.3 Percentile WEC estimate*

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

As discussed above, we do not support reducing the wholesale cost allowance from the 75th to the 50th percentile, as the 50th percentile does not reflect the asymmetric and tail-driven nature of wholesale risk. The AER's back-cast may show cost coverage in most years, but it also shows that the 50th percentile would have failed in some years; precisely the periods that justify maintaining a higher percentile. Lowering it now, alongside the removal of the competition allowance and reduced retail margins, would further erode cost recovery and weaken retailers' resilience during high-price events, ultimately undermining sustainable market conditions in consumers' long-term interests.

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

If the percentile WEC estimate is reduced to the 50th percentile, we believe a volatility allowance would be vital. Retailers will require an allowance to acknowledge the cost of working capital required to be held to cover prudential and contractual exposure. A volatility allowance would not be necessary if the percentile was set at a reasonable level, as this would achieve the same outcome, without the further complexity of calculating a volatility allowance that would apply to retailers with very different prudential and risk profiles, access to finance and credit ratings.

**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?

We do not agree that the 50th percentile WEC estimate reflects the efficient costs of supply. It does not align with how a prudent retailer manages risk and would materially increase retailers' exposure to wholesale volatility. The proposal also comes at a time when the growing share of variable renewable generation is increasing reliance on higher-cost gas and other firming capacity to manage periods of low output. In this context, we consider it more likely that wholesale market uncertainty will, if anything, increase, particularly while key transmission developments remain delayed.

### *5.4 New morning and evening peak contracts*

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

We believe that the AER and its consultants should analyse the volume of new products traded as the basis for inclusion in the hedging strategy. A materiality threshold might be the best approach, showing active trades and activity around a new product. We are not in a position to recommend a precise threshold but believe the basis for any parameters should be assessed periodically.

### *5.5 Time-of use wholesale energy costs*

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

Alina Energy supports an approach to apportioning the WEC across multiple time periods to support the expression of the DMO as a tariff (including a time-of-use DMO). The approach set out in section 5.5 of the issues paper and applied by the Queensland Competition Authority would seem appropriate.

## Chapter 7: Retail and other costs approach

### *7.2 Cost to serve*

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

Alinta Energy supports maintaining the current approach to cost to serve by applying the customer-weighted average cost to serve of all retailers. Retailers do not separately account the cost to serve standing and market offer customers and the data provided by retailers to the AER has outliers removed and reflects the actual costs of retailers who are participating in a highly competitive environment.

### *7.3 Costs to acquire and retain customers*

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

We do not support the proposal to apply a ‘modest’ cost to acquire and retain customers as recommended by the Department. Standing-offer customers benefit from these activities as well, by being informed of and moving to market offers that are better suited to their circumstances and preferences than a standing offer. These activities play a critical role in helping customers understand their options, encouraging engagement, and facilitating competition; outcomes that ultimately support efficiency and the long-term interests of all consumers.

Of the two options being considered by the AER to quantify modest customer acquisition and retention costs, we support option 1, which, while heavily reflecting the cost to acquire and retain of the largest three retailers (and thereby not reflecting the economies of scale of a representative retailer), is superior to the arbitrary indexation approach applied by the Essential Services Commission of Victoria.

Any reduction in customer acquisition and retention costs will impact customers through reduced innovation and competition, which ultimately diminishes the long-term benefits of the contestable retail energy market for all consumers.

### *7.4 Bad debt*

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

Bad debt should continue to be allocated to the fixed component of retailer costs. Customers of any size can trigger bad debt costs, and it is unclear how a split of variable and fixed costs would be determined and on what basis. Allocating bad debt on a variable basis would require larger-use customers to fund a disproportionate share of these costs simply because they consume more energy. This would create inequitable cross-subsidies and undermine the cost-reflective intent of the DMO. Retaining bad debt within the fixed component avoids these distortions.

## Chapter 8: Retail margin and competition allowance

### *8.1 Efficient margins*

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

As per our comments above, we strongly believe the current approach to the retail margin needs to be maintained and already reflects the efficient margin. The data sources identified by the AER on page 44 of the issues paper will not reflect the dynamic nature of risk facing energy retailers or lack relevance to the competitive market in which the DMO is applied.

Applying false precision through analysis of data sources that are inconsistent, not contemporaneous or irrelevant to the markets that retailers regulated under the DMO operate in order to identify an 'efficient' retail margin could materially impact retailer viability, performance and innovation, with little relative impact on customer bills (particularly when compared to network charges) limited benefits to the customer.

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

For the reasons discussed in our cover letter above, we believe the margin for small business customers should continue to reflect the unique risks involved in retailing to this cohort. The current 11% margin should be retained and remain higher than the residential margin. Reducing the small business margin dramatically under the DMO would risk undermining the viability of serving this segment, with potential consequences for the availability of competitive market offers and customer choice.

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

The retail margin should continue to be applied as a percentage of the overall DMO cost stack, rather than apportioned into separate fixed and variable components. Applying the margin on a percentage basis, as the AER has done historically, provides retailers with greater certainty over the return on operating a retail energy business and ensures that the allowed margin appropriately moves with changes in the underlying cost stack over time.

We do not support a hybrid approach that allocates margin across fixed and variable elements. Such an approach would require ongoing rebalancing between components and would likely be subject to frequent adjustment as individual cost inputs evolve. This would reduce regulatory certainty and create unnecessary complexity, replicating challenges experienced with other parts of the DMO methodology.

Retaining a simple percentage-based margin avoids these issues and supports a more stable and predictable framework for both retailers and customers

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

We support the current return-on-risk approach to the retail margin. The margin included in the DMO is already historically low, and any further reduction would weaken the alignment between the risks retailers carry, to invest, compete and innovate, and the returns available in alternative investments. The relative impact of such a change on the DMO is marginal compared with the impact of other cost components, in particular network costs. In fact, increases in network charges, such as those driven by the NSW Energy Roadmap, can outweigh any change to the retail margin many times over, and have set NSW DMO outcomes apart from other distribution areas in DMO7.