28 November 2025

Natalie Elkins
General Manager, Market Performance
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Submitted by email: DMO@aer.gov.au

Dear Ms Elkins,

Default market offer prices 2026-27 – Issues Paper

Origin Energy Limited (Origin) welcomes the opportunity to provide comments on the Australian Energy Regulator's (AER) Default market offer (DMO) prices 2026-27 Issues Paper.

We recognise that the Commonwealth has announced changes to the DMO framework, introducing a new guiding DMO objective for the AER to consider efficient costs of supplying small customers on standing offers. This implies greater alignment of the DMO methodology with that of the Victorian Default Offer (VDO) which is deemed to be an efficient price.

While there are some differences between the DMO / VDO methodologies, we consider the DMO is already an efficient price. This is notwithstanding the greater emphasis in encouraging competition relative to the VDO, which we consider to be crucial (and warranted) given the National Energy Customer Framework (NECF) states do not have as long a history with competition as Victoria.

Retailers also continue to operate in a high-risk, low EBITDA return environment, which means the allowable margin under the DMO must be commensurate with these conditions. EBITDA margins have generally trended downward, particularly in the NECF states, indicating that retailers are not making excessive profits.

Further reductions to the DMO risk unintended consequences, such as undermining competition and innovation, which is not in the best interest of consumers. The NEM is at a critical juncture in this context, with enabling technology (smart meters) being rolled out and the regulatory framework (CER roadmap) being developed. Retailers should be given latitude to innovate and compete, and the DMO should support, not constrain, this momentum.

Finally, comparisons between Victoria and regions where the DMO applies must be approached with caution. There is greater wholesale market volatility in NEM regions outside of Victoria, which benefits from lower-cost brown coal and strong interconnection.

It is within this context we have framed our discussion of the various matters raised in the Issues Paper.

Wholesale Energy Cost

Origin is concerned about the suggestion of lowering the WEC estimate from the 75th to the 50th percentile which does not appropriately reflect the risk and uncertainty faced by retailers in navigating a volatile wholesale market. At the 50th percentile retailers using similar hedging strategies to the DMO would not have recovered their costs in 16% of instances across regions and determination years. The inability of retailers to recover their efficient wholesale costs under a significant number of plausible scenarios would result in an unacceptable level of financial risk.

If the AER proceeds with a 50th percentile WEC, it is critical that a volatility allowance is adopted to partially offset the increased risk associated with using a lower percentile WEC. This noting that a volatility allowance is included even in the relatively less volatile Victorian context under the VDO.

Retail Costs

The DCCEEW Outcomes Paper has proposed a mandatory obligation for the AER to consider efficient costs to supply small customers on standing offers, including modest costs for customer acquisition and retention.

The AER in the DMO Issues Paper has interpreted this directive by seeking to derive retail costs applicable only to standing offer customers, rather than to customers more broadly. However, we do not support calculating a separate retail cost for standing offer customers. The cost to serve a standing offer customer is no different from that of a market offer customer. Both are serviced under the same operating model, using the same billing system, call centre, and support staff.

In this instance, the approach under the VDO is appropriate whereby a weighted average of retailer costs is derived. This approach considers economies of scale and therefore creates a continuous incentive for all retailers to pursue efficiency improvements to meet the cost benchmark and drive long-term operational savings.

Retail Allowance

Appropriate risk compensation is an important part in setting the retail margin. We believe an efficient margin must allow for a return commensurate with the regulatory and commercial risks of delivering retail services in the current environment.

The risks and costs of being a retailer in the NEM have increased over the past few years, with some of the key cost stack elements like wholesale costs becoming harder to predict. In addition, there is increased policy and regulatory uncertainty. For example, the Government has recently introduced the requirement for retailers to offer a standing offer that provides 3 hours of free energy (the Solar Sharer Offer) per day to customers with a smart meter. We are still waiting for details regarding the operation and calculation of this tariff.

In addition, when making comparisons with the margins in other jurisdictions, it vital the AER recognise different operating conditions. For example, retailers face higher wholesale market volatility and risk in hedging their retail load in the DMO regions compared to Victoria. In addition, profitability levels of retailers in the NECF states are lower meaning they are less able to manage any further reductions in the retail margin in the DMO.

Against this background and the trend of growing risks for retailers, in the interest of promoting regulatory certainty and encouraging investment, it is important that existing margins are maintained.

The AER is also considering whether the retail margin should continue to be expressed as a fixed percentage across the total DMO cost base, or whether it should include both fixed dollar and variable percentage components.

We have seen several examples since the introduction of the DMO where retailers have been exposed to unprecedented increases in the wholesale energy cost which have exposed retailers to added risk. It is crucial to preserve the link between the cash flows of the retailer and the required retail margin. For this reason, it is appropriate that the margin continue to be expressed as a percentage of the bill.

Network Prices

Origin supports an approach to assign the DMO tariff with corresponding network tariff structure i.e. the flat DMO should reflect the flat network tariff, and the TOU DMO should reflect the most common network TOU in the relevant distribution region.

In terms of establishing a single reference bill we support separate reference bills for each of the flat DMO and TOU DMO. This will enable customers to make a consistent comparison of their chosen retail tariff structure with the relevant DMO i.e. a flat market offer should be referenced to the flat DMO and a market TOU with the TOU DMO.

If you wish to discuss any aspect of this submission further, please contact Sean Greenup (sean.greenup@originenergy.com.au) or Shaun Cole (shaun.cole@originenergy.com.au).

Yours Sincerely,

Steve Reid
General Manager, Regulatory Policy

1. Wholesale energy cost

2. Wholesale energy cost

[1] The Issues Paper identified several important matters for consideration related to the WEC, including the choice of modelled percentiles and the controlled load methodology. We discuss these and other issues below.

1.1 Percentile WEC estimate

[2] As we have outlined in previous submissions to the AER, we consider that balancing the allocation of risk between retailers and consumers is best achieved by adopting the 95th percentile of modelled WEC outcomes given the inherent uncertainties associated with estimating that component of the DMO and modelling spot prices. This is a key reason ACIL Allen has historically adopted the 95th percentile of the distribution of WECs as part of its modelling approach, which is also utilised by the Queensland Competition Authority (QCA) in setting regulated electricity prices in regional Queensland.

[3] As part of this work for the QCA, ACIL Allen has noted that 'the error in the WEC estimate, due to contract price variation, is likely to be greater in an environment of increasing prices, than it is in an environment of decreasing prices. This is because of the skewed nature of wholesale electricity prices in the NEM – prices can increase a lot more than they can decrease – and demonstrates the risk faced by retailers. This is another reason to adopt a higher percentile of the simulated WECs'.[1]

[4] The AER is now considering lowering the WEC estimate from the 75th to the 50th percentile. We consider there is a material risk in the current environment (i.e. a transitioning market with elevated levels of volatility) that this approach would result in WEC estimates that do not reflect the actual costs incurred by a prudent retailer during a DMO period.

[5] The AER has published a supplementary report to the DMO 8 issues paper examining the performance of the wholesale cost model. This report by ACIL Allen concluded that in most determination years its model's spot price forecasts underestimated the spot prices that eventuated in the market.[2] However, the 'underestimation of actual spot prices often resulted in overestimation of the WEC due to the risk averse modelled hedging strategy'.[3]

[6] Origin does not consider this theoretical outcome would be realised in practice given potential limitations with the model. While we acknowledge the performance of the hedging strategy has been tested as part of the AER's supplementary analysis, we remain of the view that it does not sufficiently reflect that of a prudent retailer. In particular, that the high proportion of cap contracts and low volume of baseload swaps resulted in greater exposure to energy (i.e. below $300/MWh) prices and consequently a riskier portfolio when compared to the strategy used for DMO 4. This acknowledged in the report, which notes '… the hedging strategy does leave a considerable portion of the modelled retailer's load exposed to the spot market.'[4]

[7] We have also observed that this shift has potentially been driven by the high level of modelled positive cap contract payouts, which put downward pressure on the WEC. This means that the

[1] ACIL Allen, *Estimated energy costs for use by the Queensland Competition Authority in its Draft Determination of 2024-25 retail electricity tariffs,* p. 25.
[2] ACIL Allen, *Assessing the performance of the wholesale cost model*, p. 3.
[3] Ibid, p. 1.
[4] Ibid, p 19.

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DMO modelling understates the likely costs / risks for retailers associated with potential variability in both energy and capacity prices.

[8] ACIL Allen's review also showed that at the 50th percentile, retailers using similar hedging strategies to the DMO would not have recovered their costs in 16% of instances across regions and determination years. This is a significant finding, to the extent it demonstrates the heightened potential for under recovery associated with that approach. When considered alongside the other potential changes to the DMO methodology outlined in the Issues Paper (e.g. changes to the form / level of retailer margins), this would further increase the risk of operating in the retail market, particularly for smaller retailers, which could ultimately undermine competition and be to the detriment of consumers in the longer term.

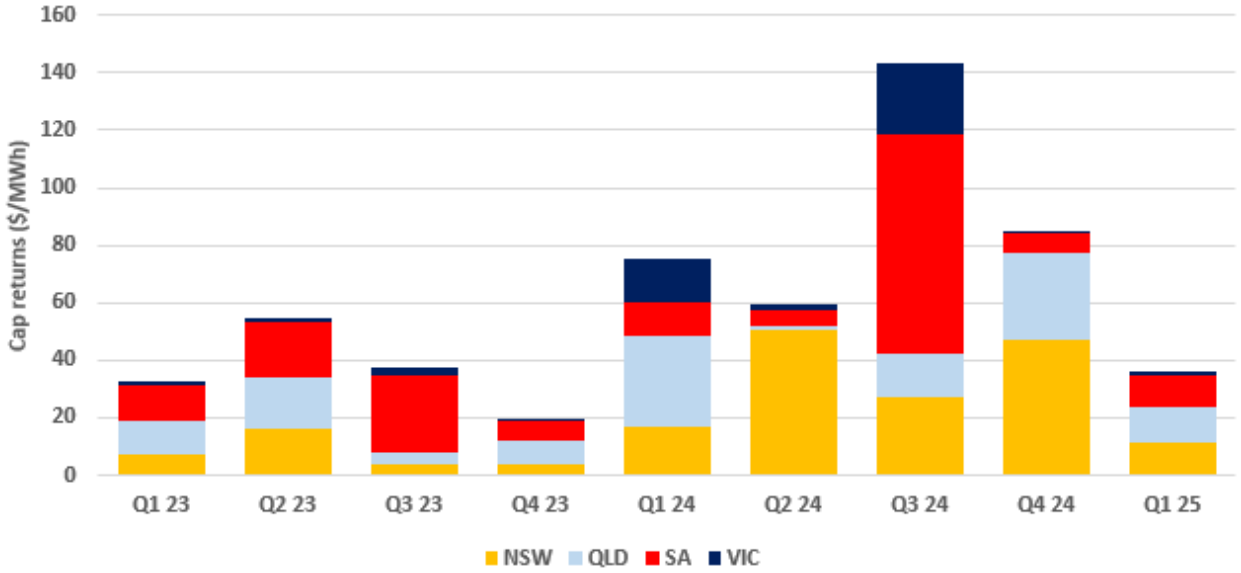
1.2 Volatility allowance

[9] If the AER proceeds with a 50th percentile WEC, it is critical that a volatility allowance is adopted to partially offset the increased risk of under recovery associated with the approach. This would be consistent with the approach applied when determining the Victorian Default Offer (VDO), with the Essential Services Commission (ESC) concluding that it is necessary to provide a volatility allowance to cover the cost to retailers of holding working capital to fund spot market purchases during periods of very high spot prices (which are unexpected and hard to predict).[5]

[10] Including a volatility allowance would also be rational, noting retailers face higher wholesale market volatility and risk in hedging their retail load in the DMO regions compared to Victoria. This is demonstrated in Diagram 1 below which shows cap returns (which is a measure of volatility) being much higher in SA, QLD and NSW compared to Victoria. Victoria's location in the centre of the NEM and its strong transmission links to multiple neighbouring regions also plays a key role in limiting price volatility. These interconnectors provide greater access to external supply when needed, as well as the ability to export surplus generation during periods of low local demand or high renewable output.

[5] ESC, *Victorian Default Offer 2025-26, Final Decision*, p. 33.

Diagram 1: Cap returns by region (quarterly)



Source: AEMO, 'Quarterly Energy Dynamics – Q1 2025 workbook', Figure 18 tab.

[11] The proposed approach to calculating the volatility allowance (i.e. multiplying the difference between the 50th and 100th percentile WEC estimates by the weighted average cost of capital in a given region) also appears reasonable.

1.3 New Morning and Evening Peak Contracts

[12] We agree that the new morning and evening peak contracts introduced by the ASX should not be included in the hedging strategy employed for the DMO, at this time because these contracts have seen limited traded volumes to date.

[13] The AER should consider including these products when / if traded volumes exceed 10-15% of scheduled demand (in GWh). At this volume, the contracts could represent a reliable input to the modelling.

1.4 Controlled load methodology

[14] As highlighted in previous submissions, we support the AER's option 1 to transition to interval meter data in DMO 8.

1.5 Time-of-use wholesale energy costs

[15] We consider that the application of a TOU DMO should maintain the same level of WEC but change the way WEC is recovered throughout the day. In this regard we support apportioning WEC across multiple time periods by deriving a set of weightings for different time periods based on the distribution of demand-weighted spot price variations throughout the day.

Recommendation

- We support retaining the 75th percentile. The use of the 50th percentile will create an unacceptable risk that retailers will not recover their WEC applying the AER hedging strategy in all scenarios.

- If the AER does adopt a 50th percentile, the increased risks of retailers being exposed to under recovery must be addressed thorough the introduction of a volatility allowance.
- We support the AER using interval meter data to develop the controlled load profile for all networks.

3. Retail Costs

2.1 Costs to Serve

[16] For DMO 8, the AER is required to adopt a methodology that best quantifies the efficient costs to supply small customers on standing offers. The objective of setting efficient costs aligns with the ESC's objectives in setting the VDO.

[17] In making its determination, the ESC calculated a single retail operating cost benchmark applicable to both customer segments by determining the customer-weighted average of retailers' actual reported costs adjusted for the difference in the Consumer Pricing Index (CPI).[6]

[18] The ESC acknowledged that individual retailers may incur operating costs that differ from its benchmark. However, it stressed that the purpose of the benchmark is to reflect the efficient cost of providing electricity, not the average or most common cost incurred by individual retailers – whether large or small. It also noted that setting a weighted average considers economies of scale because costs are skewed towards efficient tier 1 retailers which it concluded is better suited in generating an efficient cost benchmark. [7]

[19] We agree with the ESC's approach to calculate a single retail operating cost benchmark applicable to both standing and market customers. The costs to serve a standing offer customer are no different to serve a market offer customer. They are both serviced under the same operating model, using the same billing system, call centre, and support staff. The only material difference is the types of contracts; with the standing offer contracts offering higher levels of consumer protections. For this reason, we do not believe the AER should differentiate between these customer types.

[20] We also support the ESC's approach to apply a weighted average of retailer costs. As noted, this approach considers economies of scale and therefore creates a continuous incentive for all retailers to pursue efficiency improvements to meet the cost benchmark and drive long-term operational savings.

2.2 Costs to acquire and retain customers

[21] DCCEEW has recommended that the AER include modest costs associated with customer acquisition and retention. However, DCCEEW has not defined modest. Furthermore, modest does not have an economic or regulatory interpretation. As a result, any determination of modest will be subjective, meaning more regulatory discretion and potentially more regulatory risk.

[22] The best guidance we have is how the ESC has applied its terms of reference which requires it to include a modest allowance for customer acquisition and retention costs (CARC) in calculating the VDO.

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[6] ESC, Victorian Default Offer 2025-26, p. 41.

[7] ESC, Victorian Default Offer 2025-26, p. 43.

[23] In making its initial decision in 2019, the ESC expressed concern about the magnitude of the year on year movements in CARC and that they were not confident in deriving a reliable baseline. The ESC raised concerns that CARC activity promoted more switching, but more switching may also promote efforts by retailers to retain existing customers which both led to higher costs. It also noted there were no regulatory decisions in recent years on which it could rely.

[24] To address its concerns about CARC volatility, the ESC adopted an earlier data set taking the average CARC across competitive NEM jurisdictions for 2013–14 updated for inflation.

[25] Since 2016-17, CARC in the NEM has remained relatively stable at on average about $60 per customer. This suggests that the ESC's concerns about volatility and over-inflation are no longer prevalent in reported CARC values.

[26] For that reason, we consider taking the most recent (or weighted average over say the last 3 years) provides for a transparent and consistent approach to deriving a CARC value. This would also capture economies of scale in generating an efficient cost benchmark and would be consistent with the ESC approach with the only difference being the use of more up to data inputs.

2.3 Bad and Doubtful Debts (BDD)

[27] We do not support the AER's approach to use debt written off as the basis for the BDD allowance and not debt written off.

[28] It is common business practise, not just in retail energy, to make a provision for bad debt in company accounts and to cover this cost through the broader pricing of their goods and services. Retailers adjust their provision estimates each year (consistent with Accounting Standards) and eventually finalise them through write-offs. Provisioning therefore can create a smoother profile of debt relative to actual debt-debt written off which can fluctuate significantly from one year to the next.

[29] We consider the provisions for BDD calculated consistent with Australian Accounting Standards should be maintained.

2.4 Smart meter costs

[30] We support the AER's decision to continue the current approach of using historic installation data until the legacy meter retirement plans are in place. Retailers face significant costs relating to smart meters and it is essential that these costs are included in the DMO price.

[31] We retain our view that a working capital allowance is necessary to cover the cash flow shortfall between a meter installation and cost recovery. This allowance carries greater importance because of the significant increase in forecast installations following the AEMC's accelerated smart meter rule change. In this regard, we support the use of historic installation data until the legacy meter retirement plans are in place. When coupled with a working capital allowance we believe this provides for a more accurate approach to deriving smart meter costs compared to relying on forecasting installation numbers and costs.

Recommendation

- We support the AER calculating retail operating costs and CARC based on the weighted average of supplying all small customers.
- We support the current approach of determining meter costs based on forecast installation with a working capital allowance.

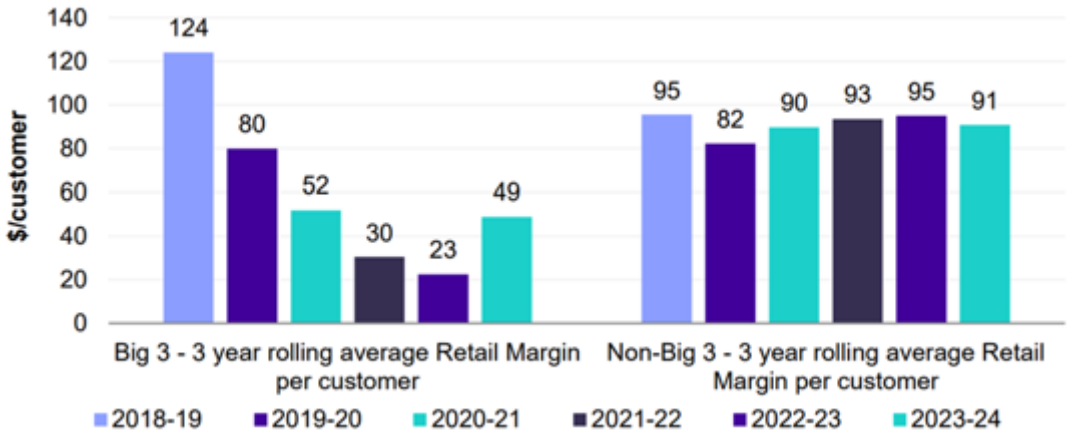
3. Retail margin

3.1 Retail margin

[32] The retail margin is intended to provide retailers with a reasonable return on investment and help manage risk while also protecting customers from excessive prices.

[33] As shown in Diagram 2 below, EBITDA margins have consistently trended downward (particularly for Tier 1 retailers) which indicates retailers are not making excessive returns, and that regulated pricing has served to constrain profitability.

Diagram 2: Three year rolling average retail margins per residential customer across the NEM, by retailer tier, (2018-19 to 2023-24, real terms, ex. GST)[8]



[34] Appropriate risk compensation is an important part in setting the retail margin. We believe an efficient margin must allow for a return commensurate with the regulatory and commercial risks involved in providing retail services in the current environment.

[35] The risks and costs of being a retailer in the NEM have increased over the past few years, with some of the key cost stack elements like wholesale costs becoming harder to predict. In addition, there is increased policy and regulatory uncertainty. For example, the Government has recently introduced the requirement for retailers to offer a standing offer that provides 3 hours of free energy (the Solar Sharer Offer) per day to customers with a smart meter. We are still waiting for details regarding the operation and calculation of this tariff.

[36] In making comparisons with the margins in other jurisdictions, it is also vital that the AER recognise different operating conditions.

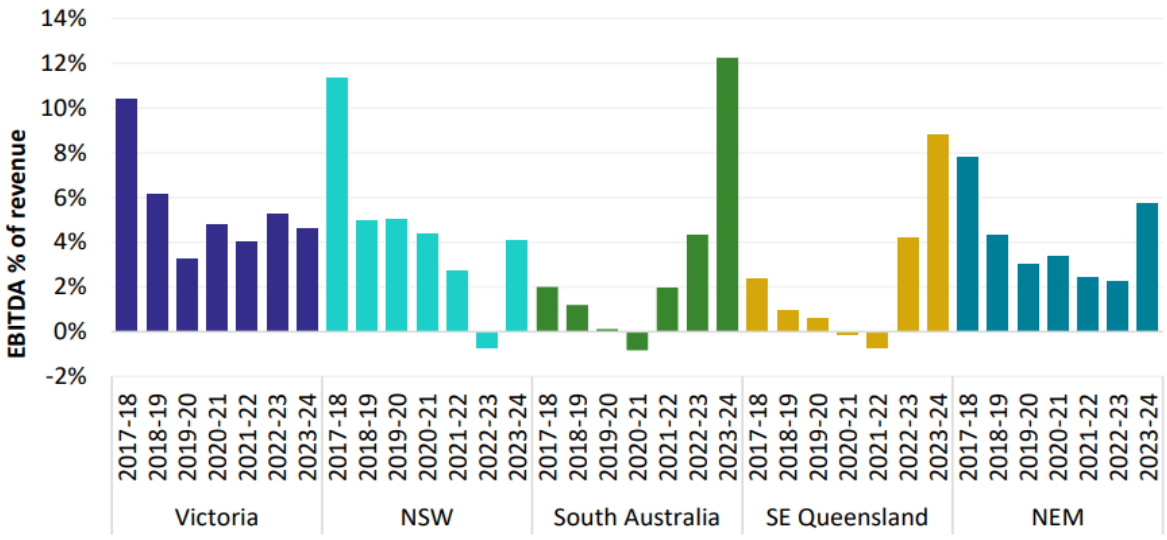
[37] The ESC has reduced its retail margin from 5.3% to 5% in its last VDO decision (2025-26) which follows a reduction from 5.7% to 5.3% in 2023-24. At this point it is too soon to tell what impact these reductions will have on competition and the Victorian market more broadly, and it would therefore be premature to follow a similar pattern for the DMO.

[38] This is supported by observing retail profitability as measured by EBITDA margins. While retail EBITDA margins have generally trended downward across the NEM this has been even more so

[8] ACCC, Inquiry into the National Electricity Market – December 2024 Report, 3 December 2024, p. 77.

in regions outside of Victoria. As seen in Figure 3 below, retail profitability over the period 2017-18 to 2023-24 averaged 4.0% in NSW, 3.1% in SA, 2.3% in QLD compared to 5.0% in Victoria. This means retailers in the NECF states are less able to manage any further reductions in the retail allowance (margin) in the DMO.

Figure 3 Retail EBITDA margins by NEM region, 2017–18 to 2023–24[9]



[39] As discussed at paragraph 10 of this submission, retailers also face higher wholesale market volatility and risk in hedging their retail load in the DMO regions compared to Victoria.

[40] Against this background and the trend of growing risks for retailers, we draw on the advice form the AER's consultants (ACIL Allen) that suggested that in the interest of promoting regulatory certainty and encouraging investment, it is important that existing margins are maintained.

3.2 Form of the retail margins

[41] As discussed, the retail margin must compensate retailers for the systematic risks they face in providing regulated retailing services. These risks include differences between the actual regulated load profile being different to that assumed in setting regulated prices due to changes in economic conditions and demand. This may mean a retailers actual energy purchase costs are different to those assumed in setting regulated prices.

[42] Electricity retailing is a financial capital-intensive business, with high short-term capital (or 'working capital') and longer-term capital (mix of debt and equity capital) requirements. Retailers enter into hedging contracts and post collateral on an ex-ante basis, purchase electricity in real time (weekly settlement) and incur operating costs on an ongoing basis. These costs are then recovered from customers on a delayed ex-post basis via electricity bills. This is especially the case for residential and SME customers who typically pay their bills on a monthly or quarterly basis in arrears, and for whom retailers hedge furthest in advance for. Therefore, when the electricity market is facing sustained high prices and volatility, there is an increase in retailer

[9] ACCC, 'Inquiry into the National Electricity Market – December 2024 Report', 3 December 2024, p. 75.

working capital requirements. Technically this would not need to be accounted for in the retail allowance if increases in capital requirements are fully reflected in components of the DMO.

[43] This underscores the importance of the retail margin which should help provide a safety net that retailers can use to absorb additional costs as they arise due to inconsistencies between the DMO and actual costs faced throughout the year. This is particularly important given the risk other DMO cost stack components may underestimate actual costs faced by some or all retailers – an inevitable risk given the retailer pool is diverse, and market dynamics and costs cannot be fully anticipated over the 12-month review cycle.

[44] Therefore, it is crucial to preserve the link between the cash flows of the retailer and the required retail margin.

[45] We believe setting the retail allowance as a fixed dollar amount would create a disconnect between the costs of a retailer and risk-based returns. Failure to set the allowance appropriately would diminish the attractiveness of the industry for prospective new entrants, lessen competition in price discounting and have a chilling effect on investment in innovation.

Recommendation(s)

- The AER maintain the current approach in setting the retail allowance as a percentage of the DMO price.

2.3 Differences in residential and small business retail allowances

[46] We support different margins applying to residential and small business customers because this allows for retailers to be compensated for the different risk profiles that apply to residential and SME customers.

[47] SME customers should attract a higher margin to reflect the relative higher risk of serving these customers. These risks have been acknowledged by the AER. They have also been recognised by other regulators. The QCA has noted that serving customers on small business tariffs carries higher retail costs than serving residential customers, on average. The QCA considered possible reasons for this were that residential and business customers had different risk profiles and as a result, retailers may require a higher return on their SME customers.[10]

Recommendation(s)

- The AER maintain the current approach of applying the different target margins of 6 per cent to residential customers and 10 per cent to SME customers.
- The AER retain its approach of applying the retail margin to the DMO cost stack.

4. Network costs

[48] The AER has been directed to determine a separate flat rate DMO and a TOU DMO.

[10] QCA, Final determination, Regulated retail electricity prices for 2016–17, May 2016, p. 29.

[49] Origin supports an approach to assign the DMO tariff with corresponding network tariff structure i.e. the flat DMO should reflect the flat network tariff, and the TOU DMO should reflect the most common network TOU in the relevant distribution region.

[50] In terms of establishing a single reference bill we support separate reference bills for each of the flat DMO and TOU DMO. This will enable customers to make a consistent comparison of their chosen retail tariff structure with the relevant DMO i.e. a flat market offer should be referenced to the flat DMO and a market TOU with the TOU DMO.

Recommendations

- Support the calculation of the flat DMO and TOU DMO aligning with the most common corresponding network tariffs.
- Support separate reference bill for the flat DMO and the TOU DMO.

5. Environmental costs

[51] Origin supports the current market-based approach to determining environmental costs.