

# Compliance Quarter

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## Submission to the Australian Energy Regulator

### Default Market Offer 2026-27

Draft Determination (DMO 8)

8 April 2026

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## 1 Executive Summary

Compliance Quarter welcomes the opportunity to make a submission on the Australian Energy Regulator's Draft Determination for the Default Market Offer 2026-27 (DMO 8).

Compliance Quarter is an energy compliance advisory firm. We advise retailers, networks, and new market entrants on compliance with the National Energy Retail Law, the National Energy Retail Rules, and associated regulatory instruments. We have a particular interest in ensuring that the DMO framework supports both effective consumer protection and workable retail compliance outcomes. This submission is made on our own behalf and not on behalf of any client.

This submission addresses a single issue: the apportionment of costs between the daily supply charge and usage charges in the DMO tariff caps, and the consequences of the AER's draft approach for low-usage customers, retailer flexibility, and competitive market dynamics.

In summary, Compliance Quarter's position is as follows:

- The draft determination's approach of passing through fixed costs directly to the daily supply charge produces daily supply charges that are materially higher than those currently observed in the market.
- Higher fixed daily charges disproportionately affect low-usage customers, including pensioners, single-person households, renters, and customers experiencing financial hardship.
- The previous DMO framework allowed retailers flexibility to allocate costs between the daily supply charge and usage charges, subject to an overall annual price cap. Removing this flexibility is a significant structural change that may produce unintended consumer outcomes.

## 2 Background and Context

### 2.1 The shift from annual prices to tariff caps

DMO 8 represents a fundamental structural change in how the Default Market Offer operates. For DMOs 1 through 7, the AER set the DMO as an annual price. Retailers were required to ensure that the annual cost of their standing offers did not exceed the DMO price. Critically, retailers retained the flexibility to determine how costs were

allocated between the daily supply charge and the per-kilowatt-hour usage charge, provided the overall annual price remained compliant.

Under the reformed regulatory framework, the AER is now required to set DMO tariff caps, comprising a maximum daily supply charge (in cents per day) and a maximum usage charge (in cents per kilowatt hour). This means retailers can no longer adjust the balance between fixed and variable charges in their standing offers. The tariff cap directly determines the structure, not merely the total price, of standing offer tariffs.

## 2.2 The AER's approach to cost allocation

The AER's draft determination allocates fixed costs to the daily supply charge and variable costs to the usage charge. The AER acknowledges that this approach has resulted in daily supply charges that are higher than those currently set by retailers in the market. As the AER itself states at section 1.1.6 of the draft determination:

*In our new role of setting DMO tariff caps, we have decided to pass through fixed and variable costs into the different tariff components (daily supply and usage charges) because these costs would be incurred by a retailer. As shown in chapter 9, this has led to a number of tariff caps with higher daily supply charges than what is currently observed in the market.*

*While overall prices are decreasing, we are conscious that these higher charges may cause bill impacts to standing offer customers with low usage, due to the fixed nature of daily supply charges.*

Compliance Quarter agrees with the AER's identification of this concern and considers that the draft determination, as currently framed, does not adequately address it.

## 3 Concerns with Higher Fixed Daily Charges

### 3.1 Disproportionate impact on low-usage customers

The fixed daily supply charge is payable regardless of consumption. A customer who uses very little electricity pays the same daily supply charge as a high-consumption customer. When a greater proportion of costs is allocated to the fixed component, low-usage customers bear a proportionally larger share of total costs relative to their consumption.

This is a matter of direct regulatory concern. The reformed DMO framework requires the AER to have regard to the types of small customers on standing offers. Many standing offer customers are disengaged from the market precisely because they face barriers to switching, whether due to age, language, digital literacy, or financial stress. These same customers tend to be lower-usage customers.

The AER's own analysis demonstrates the scale of the issue. For example, in the Ausgrid region, the draft determination residential flat rate daily supply charge is 154.85 cents per day, which equates to approximately \$565 per year in fixed charges alone, before any electricity is consumed. For a customer consuming at half the benchmark usage level, the daily supply charge would represent over 40% of their total annual bill.

### **3.2 Vulnerable and hardship customers**

Customers on hardship programs and payment plans are a particularly important cohort. The AER's draft determination notes, at section 9.3.3, that the ACCC's July 2025 Inquiry into the NEM report found that hardship and payment plan customers tend to have median usage approximately 76% and 58% higher than the general population, respectively. However, this statistic describes the median. There is a significant tail of hardship customers with low or moderate usage who would be adversely affected by higher fixed charges.

More fundamentally, for any customer experiencing financial difficulty, a higher fixed charge that cannot be reduced by behavioural change (such as reducing consumption) limits their ability to manage their energy costs. This runs counter to the long-term interests of consumers, which the AER is required to consider under the reformed framework.

### **3.3 Misalignment with energy policy objectives**

Higher fixed charges also sit uncomfortably with broader energy policy objectives. The Australian Government's energy reforms, including the Solar Sharer Offer, are designed to encourage consumers to shift consumption to periods of high solar generation. These demand-side signals operate through the variable component of pricing. If a disproportionate share of costs is embedded in the fixed charge, the price signal to shift load is diluted, reducing the effectiveness of these initiatives.

## **4 The Case for Retailer Flexibility**

### **4.1 What the previous framework allowed**

Under DMOs 1 through 7, retailers had the flexibility to set their own daily supply charges and usage charges, provided the total annual price did not exceed the DMO cap. This meant that retailers could, and did, set daily supply charges below the level that a strict cost-reflective allocation would produce. Retailers made commercial

decisions about cost recovery based on their customer base, competitive positioning, and pricing strategy.

This flexibility was not a deficiency of the previous framework. It was a feature that allowed the DMO to function as a price cap while preserving competitive dynamics and allowing retailers to offer tariff structures that suited different customer segments.

## **4.2 Why flexibility should be preserved**

Compliance Quarter submits that the AER should adopt an approach that, in so far as is possible within the regulatory framework, preserves retailer flexibility in allocating between the daily supply charge and the usage charge, subject to an overall annual price cap or appropriate constraints on each component.

There are several reasons for this:

### **a Cost recovery is not purely mechanistic**

The distinction between "fixed" and "variable" costs is not as clear-cut as the draft determination's methodology suggests. Some costs categorised as fixed (such as bad debt) have characteristics of both fixed and variable costs. The AER's own analysis in section 9.3.3 acknowledges this ambiguity and presents three options for reallocating bad debt and retail margin, none of which is entirely satisfactory.

### **b Competition is better served by flexibility**

Retailers compete on price structure as well as price level. Some retailers differentiate by offering low daily supply charges to attract low-usage customers, while recovering a larger share through usage charges. This form of competition benefits consumers. Prescribing tariff structures limits the dimensions on which retailers can compete.

### **c Consumer outcomes vary by customer segment**

A single prescribed tariff structure cannot optimise outcomes for all customer types simultaneously. Low-usage customers benefit from lower daily supply charges. High-usage customers benefit from lower usage charges. Flexibility allows the market to offer products suited to different needs.

### **d Regulatory certainty for retailers**

The three options presented in section 9.3.3 of the draft determination introduce uncertainty about how the AER will allocate costs in future determinations. A framework that allows retailer flexibility within defined bounds provides greater

regulatory certainty than one that prescribes exact cost allocations that may change from year to year.

## **5 Response to the AER's Three Options**

The AER's draft determination presents three options for adjusting the apportionment of costs to reduce the daily supply charge. Compliance Quarter offers the following observations on each.

### **5.1 Option 1: Allocating bad debt to the usage charge**

This option would reduce the daily supply charge by approximately \$0.10 to \$0.25 per day by treating bad debt as a variable cost. While this would provide modest relief, the AER correctly identifies a significant drawback: hardship and payment plan customers, who tend to have higher usage, would contribute disproportionately to bad debt recovery through the usage charge. This could exacerbate affordability pressures for the very customers the framework is intended to protect.

Compliance Quarter considers this option, if adopted in isolation, to be an insufficient response to the underlying structural concern.

### **5.2 Option 2: Allocating the retail margin to the usage charge**

This option would reduce the daily supply charge by allocating the entire retail margin to the usage charge. While this produces a more meaningful reduction in the fixed charge, it introduces methodological complexity and departs from the approach taken by other regulators (ESC, ICRC, OTTER) who apply the margin as a percentage to both fixed and variable components.

Compliance Quarter notes that this approach would also result in higher-usage customers paying a greater dollar amount for the retail margin, which may not accurately reflect the costs and risks associated with serving those customers.

### **5.3 Option 3: Shifting a percentage of the daily supply charge to usage**

This option would apply a specific percentage shift (for example, 20%) from the daily supply charge to the usage charge. The AER acknowledges that this approach is arbitrary and may not reflect how retailers incur costs. It would also introduce uncertainty about the size and direction of the adjustment in future years. It is our view that such an adjustment, both a blunt force and arbitrary mechanism, must nonetheless be considered.

While Compliance Quarter considers Option 3 to be the most pragmatically useful of the three options presented, it remains a second-best solution to the fundamental question of retailer flexibility.

## **6 Compliance Quarter's Preferred Approach**

Compliance Quarter submits that the AER should adopt a framework that:

- Sets tariff caps for both the daily supply charge and the usage charge, as required by the Regulations.
- In so far as is possible within the regulatory framework, allows retailers to set daily supply charges below the daily supply charge cap, and to recover the shortfall through usage charges, provided the usage charge does not exceed the usage charge cap.
- Retains an overall annual comparison price as a safeguard against retailers setting standing offer prices that exceed the DMO price when calculated at benchmark usage amounts.
- Requires the daily supply charge component of the tariff cap to be calculated using a methodology that produces a reasonable bound, rather than a full pass-through of all fixed costs.

This approach preserves the consumer protection function of the DMO while allowing the competitive dynamics that have historically produced daily supply charges below cost-reflective levels.

If the AER is not minded or able to adopt this preferred approach in full, Compliance Quarter supports, as a fallback, an approach based on Option 3 (a percentage shift from the daily supply charge to the usage charge) calibrated so that the resulting daily supply charges are broadly consistent with the median daily supply charges currently observed in standing offers in each distribution region.

## **7 Additional Observations**

### **7.1 Communication and transition**

Regardless of the approach adopted, DMO 8 will represent a significant structural change for both retailers and consumers. Compliance Quarter encourages the AER to consider the communication and transition implications of its final determination.

Consumers should be clearly informed about what the change means for their bills,

particularly where the daily supply charge increases but the overall annual price decreases.

## **8 Conclusion**

The reduction in overall prices across all regions is a welcome outcome for consumers. However, the approach to cost allocation between the daily supply charge and usage charges requires reconsideration. Higher fixed daily charges disproportionately affect low-usage and vulnerable customers, reduce the effectiveness of demand-side price signals, and remove a competitive dimension from the retail market.

Compliance Quarter urges the AER to seek to adopt a framework that provides retailers with flexibility to allocate costs between the daily supply charge and usage charges, subject to appropriate caps on each component and an overall annual price safeguard. This approach is consistent with the reformed Regulations, protects the long-term interests of consumers, and supports a competitive retail market.

**Compliance Quarter Pty Ltd**

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