



8 April 2025

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Submitted by email: [DMO@aer.gov.au](mailto:DMO@aer.gov.au)

Dear Ms Elkins,

### **Default market offer prices 2025-26 – Draft determination**

Origin Energy Limited (Origin) welcomes the opportunity to provide comments on the Australian Energy Regulator's (AER) Default market offer (DMO) prices 2025-26 Draft determination.

The DMO objective requires prices to be set at a level that allows retailers to recover efficient costs, while also facilitating competition, and ensuring that customers are protected from unreasonably high prices. We recognise the significant challenges faced by the AER in balancing the inherent tensions between these objectives.

We believe that the AER should examine more prudent and sustainable approaches in balancing the DMO objectives, especially where cost of living concerns endure. Wholesale and network costs are the biggest drivers of price movements in the DMO. Network costs are likely to continue to put upward pressure on the DMO because of increased expenditure to support renewable energy zones and the broader energy transition. If this trend persists, options to manage the impact of higher network costs should be explicitly looked at, as opposed to the sole focus on other parts of the cost stack.

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

### ***Wholesale Energy Cost (WEC)***

We appreciate the AER's engagement on the technical aspects of the WEC modelling. We retain our position that an assessment of the performance of the model over time using actual spot price / demand data should be undertaken. This should include assessing whether actual spot price outcomes fall within the range of modelled prices, and deriving an updated WEC using actual spot price / demand data for comparison with the modelled WEC applied for each DMO period.

While we recognise the challenges the AER has faced deriving load profiles because of data adjustments outside its control, it is vital that the AER avoid making subjective decisions. We support the AER's modellers (ACIL Allen) recommendation that an adjusted net system load profile blended with interval meter data should be used to determine load profiles to calculate the WEC.

In terms of addressing any potential modelling uncertainties in the continued uptake of rooftop PV, we contend that adopting the 95th percentile would best address these risks.

### ***Retail Allowance***

We support the AER's decision to maintain the retail margin at 6 per cent for residential customers and 11 per cent for small business customers. We believe these rates meet the objectives set out in the regulations to allow a prudent retailer faced with the typical costs of supplying electricity to customers to achieve a reasonable profit.

The level of the retail margin is particularly important given the suspension of the competition allowance which magnifies the risk of cost under-estimation.

Against the trend of growing risks for retailers, our view is that current margins should at a minimum be retained, with the AER being mindful for the need of any increase, particularly while the competition allowance remains suspended.

The preconditions for the reintroduction of the competition allowance are still somewhat ambiguous. To provide greater certainty the AER should clarify how it intends to apply its criteria of “material” and “sustained.”

In setting a future value for the competition allowance we encourage the AER to consider the objective to not only accommodate differences in retailers’ costs but to also incentivise competition. The AER’s proposed calculation method does not consider this latter objective.

### **Network Prices**

It is appropriate for the AER to consider how best to reflect changing network tariff structures in the DMO. However, it does not yet appear that the AER has access to reliable and consistent usage data to allow for the blending of flat and TOU network costs. Given this, it is appropriate that the AER retain its current approach of using flat tariffs.

In terms of the actual costs, in the absence of approved network prices, the AER should use prices submitted by the networks in their annual pricing proposals for 2025-26. These prices represent the best information available in that they should reflect the recently approved revenues and demand forecasts from the AER’s revenue determination.

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

Yours Sincerely,



Steve Reid  
General Manager, Regulatory Policy

## 1. Wholesale energy cost

- [1] The Draft determination covered several important matters related to the calculation of the WEC, including the derivation of the customer load profile, issues with the NSLP dataset, and approach to determining hedging costs in SA. We discuss these and other issues in further detail below.

### 1.1 Load profile assumptions

- [2] The AER has highlighted that following an assessment of additional NSLP data published by AEMO, its earlier concerns about the impact of AEMO adjustments following 5MS on the NSLP data have not materialised. On that basis, we support the AER's decision to use only one year of NSLP data to simulate the load profile, from October 2023 to October 2024, blended with interval meter data.
- [3] As we have raised previously, because there are marginally more accumulation meters than interval meters, retaining a blended approach offers the best representation of this split. This approach also has the advantage of using the latest available NSLP and interval meter data which means the spot price modelling is based on the latest system demand traces.
- [4] We also believe this will support a more gradual and lower risk transition to full interval meter data by DMO 8, by which time the penetration of interval meters will significantly exceed accumulation meters.
- [5] In terms of the controlled load profile for NSW, we support the use of historic controlled load profile (CLP) to forecast the load shape for DMO 7. Despite the increased penetration of interval meters we do not believe there has been a significant shift in the load shape in NSW. We believe this will allow for the CLP to transition to interval meter data in DMO 8 consistent with our proposed timing for the mass market load profile.

#### Recommendation

- We support the AER using a blended profile to develop the load profile and controlled load profile for all networks.

### 1.2 Solar PV exports and hedging costs

- [6] The AER has proposed to retain its position to account for PV exports in the load profiles for wholesale forecasting.
- [7] As ACIL note the hedging strategy tends to change when there is a sufficient change in either the shape of the load profile (for example, due to the continued uptake of rooftop PV) or a change in the relationship between contract prices for the different contract products (for example, in some years base contract prices increase much more than peak contract prices, which can influence the strategy).<sup>1</sup>
- [8] Origin recognises the AER is proposing to retain the use of the 75th percentile WEC. We agree it is important to balance the allocation of risk between retailers and consumers. However, we contend that adopting the 95th percentile would be more appropriate given the range of modelling uncertainties, including those from the impact of PV exports on the load profile. This is a key reason ACIL Allen has historically adopted the 95th percentile of the distribution of WECs as part

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<sup>1</sup> ACIL, Default Market Offer 2024-25 Wholesale energy and environment cost estimates for DMO 6, p. 16.

of its modelling approach, which is also utilised by the QCA in setting regulated electricity prices in regional Queensland.

### **1.3 Wholesale spot price modelling**

- [9] We recognise the estimated WEC for any determination will invariably be different to the actual WEC incurred. As noted by ACIL, the WEC is ultimately a function of several factors, including the actual hedging strategy adopted by a retailer (noting different retailers may have different strategies) compared with the simplified hedging strategy adopted in the methodology, the actual load profiles, spot price and contract price outcomes.<sup>2</sup>
- [10] Notwithstanding this, it would be beneficial to transparently assess the performance of the model over time using actual spot price / demand data. This includes assessing whether actual spot price outcomes fall within the range of modelled prices, and any change in the WEC when historical data is applied for a given DMO period.
- [11] Origin has previously raised concerns that the hedging strategy adopted has not sufficiently reflected that of a prudent retailer. In particular, we consider the high proportion of cap contracts and low volume of baseload swaps has resulted in greater pool price exposure for the retailer and consequently a riskier portfolio. 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. We maintain the hedging strategy should be resilient to different market outcomes. Assessing the model's performance against actual spot / market outcomes could provide useful insights, and the extent to which the modelled WEC is likely to adequately reflect the costs of an efficient retailer.

#### **Recommendation(s)**

- The performance of the WEC modelling should be transparently assessed using historical data. This should include:
  - comparing the range of modelled spot prices to actual spot outcomes; and
  - using actual spot and demand data to determine WECs for historical years.

#### Length of the book build

- [12] We support the existing book build process which occurs over a two-to-three-year period and agree pricing stability is important for customers.

### **1.4 South Australian hedging methodology**

- [13] Origin supports the AER's proposal to retain the current use of ASX Energy trade data and benchmark trade prices with broker data for swaps / caps and other OTC contract data collected. If a material misalignment in trade prices is observed, this could indicate a need to consider alternate data sources to benchmark retailer hedging costs in SA. However, it would still be important to maintain an approach that uses publicly available data that retailers would typically rely on to inform their pricing of hedging products.

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<sup>2</sup> ACIL Allen, 'Default Market Offer 2024-25 – Wholesale energy and environment cost estimates for DMO 6 Final Determination', 22 May 2024, p. 28.

### **Recommendation**

- Hedging costs in SA should continue to be determined using ASX Energy trade data and benchmarked with broker data for swaps and caps, and other OTC contract data collected by the AER.

## **1.5 Compensation costs**

- [14] We agree known AEMO and AEMC compensation costs should be passed through the DMO wholesale component.

## **1.6 Use of the 75th percentile**

- [15] Origin recognises the AER is proposing to retain the use of the 75th percentile WEC and agrees it is important to balance the allocation of risk between retailers and consumers. However, we contend that adopting the 95th percentile would be more appropriate given the range of modelling uncertainties discussed above and risk that modelled WEC estimates may not reflect the actual costs incurred by a prudent retailer during a DMO period.

## **2. Retail Costs**

### **2.1 Retail costs**

- [16] We support the AER collecting retailer cost information that replicates the cost categories requested by the ACCC and used by the AER in previous DMO determinations. By using a consistent data time series this will reduce the risk of regulatory error. Reporting against a consistent set of data will also improve efficiency as businesses can rely on established data collection systems and processes to extract and report this information.
- [17] We also support the AER's decision to collect data from an expanded set of retailers. The extended database will provide a better representation of costs faced by the wider retail sector and reduces sampling errors or bias.

### **2.2 Bad and Doubtful Debts (BDD)**

- [18] We retain our support for the calculation of BDD for residential and small business to continue to be based on the state-based weighted average as reported by the ACCC. This provides for a larger sample of data and provides for a consistent definition of costs across all retailers.
- [19] Applying the ACCC data to determine jurisdiction specific BDD values also reduces cross-subsidies compared to a NEM average.

### **2.3 Smart meter costs**

- [20] 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.
- [21] 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 decision to apply the retail costs categories used in previous DMO determinations and to also expand the sample size.
- We support the current approach of determining meter costs based on forecast installation with a working capital allowance.

### **3. Retail margin and competition allowance**

#### **3.1 Retail margin**

- [22] We support the AER's decision to maintain the retail margin at 6 per cent for residential customers and 11 per cent for small business customers. We believe these rates meet the objectives set out the regulations to allow a prudent retailer faced with the typical costs of supplying electricity to customers to achieve a reasonable profit.
- [23] In assessing the appropriate margin, we agree it is important to consider the relationship between the retail margin and EBITDA.
- [24] The retail margin should compensate retailers for the level of risk that they face operating in the defined market. The greater the risk, the greater the retail margin that is required to ensure that capital invested in the business earns an appropriate return. EBITDA on the other hand is a measure of a retailer's operating profitability.
- [25] The AER found that while on average retailers made losses on new customer acquisitions, aggregated data across all retailers revealed a weighted average inferred EBITDA of 5.6 per cent. This demonstrates that under the current DMO retailers have been able to achieve a reasonable rate of return relative to the AER's retail margin.
- [26] In terms of comparison to other jurisdictions, the most widely used analysis is the Frontier Economics' (Frontier) expected returns modelling. The key objective of the expected returns approach is to estimate the minimum retail margin required to compensate equity investors in a notional electricity retailer for the systematic (i.e., non-diversifiable) risk they bear when committing equity capital to a firm.
- [27] Frontier run a range potential scenarios assuming different risk profiles and market conditions to derive a rank-ordered estimated of margins. The AER's current margin of 6 per cent falls at about the 66th percentile in this range.<sup>3</sup>
- [28] Based on the fact that retailers are not achieving excessive EBITDA returns, that the current margin is set at a conservative level (i.e. the 66<sup>th</sup> percentile) and the continued suspension of the

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<sup>3</sup> Frontier Economics, Retail electricity price investigation 2024-27 Report for The Independent Competition and Regulatory Commission, 21 November 2023, p. 61-62.

competition allowance, we consider there is little evidence to support a change to the retail margin.

### **3.2 Competition allowance**

- [29] The objective of the competition allowance is to accommodate differences in retailers' costs and to provide room for competition.<sup>4</sup> In terms of the latter we consider this to mean an allowance that will incentivise competition and consumer engagement.
- [30] For DMO 6, the AER determined a competition allowance of \$66 for residential customers and \$291.50 for small business customers. This has been revised downward for DMO 7 to \$20.71 for residential customers and \$23.08 for small business customers.
- [31] We understand that the AER has derived these figures to allow retailers selling to 90% of the market to be able to recover their retail operating costs. However, we do not believe setting a competition allowance that will only allow most retailers to recover their costs is sufficient to incentivise competition and promote consumer engagement.
- [32] It is important that customers are more engaged as the power system transforms. It is also important that retailers are incentivised and have the confidence to invest to pursue greater product innovation and bundling. This will translate into more engagement and more real choices targeted to the specific needs of individual households.
- [33] We are concerned that an allowance of \$20 is not sufficient to provide retailers with the necessary confidence to invest to pursue these outcomes. While this allowance meets the objective of accommodating differences in retailers' costs, it does not meet the objective to provide room for competition.
- [34] We consider that the AER should re-consider its approach to ensure that the competition allowance is not designed as a cost recovery amount but is calculated on the basis to stimulate competition.

### **Preconditions for applying the competition allowance**

- [35] We support the AER's proposed definition of CPI as the trimmed mean. We agree this provides a more stable underlying trend in inflation.
- [36] However, we consider that the preconditions for the reintroduction of the competition allowance are still somewhat ambiguous. To provide regulatory certainty the AER should clarify its criteria of "material" and "sustained" and explain how these will be applied in practise.

#### **Recommendation**

- We support the position that current margins should at a minimum be retained.
- That the AER reconsider whether its allowance of \$20 is sufficient to meet the competition allowance objective of "to provide room for competition".
- The AER provide a clear and concise criteria for the reintroduction of the competition allowance.

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<sup>4</sup> AER, Default market offer prices 2024-25: draft determination, p. 53.

## 4. Network costs

### 4.1 Flat rate and time of use network tariffs

- [37] We support the AER's decision to retain the use of flat network tariffs for the purposes of DMO 7.
- [38] Deriving an average annual time of use network cost is complex to calculate as it requires information on the amount of energy consumed in each of the networks' charging windows for an average customer.
- [39] To the extent that the AER's new retail performance reporting guidelines provide the necessary information, we support this issue being re-considered ahead of the process for DMO 8. We consider the AER could work with retailers following the publication of the first quarterly report under the new retail performance reporting guidelines to understand how this data would in practise enable a blended profile.
- [40] We think this could be undertaken ahead of the DMO 8 Issues Paper.

### 4.2 Queensland and South Australian networks revenue determinations

- [41] Origin acknowledges that the AER has used the best possible estimates to calculate network costs for the Queensland and SAPN for the draft determination given they are currently undergoing revenue resets.
- [42] Notwithstanding, we retain the concerns raised in our submission in response to the Issues Paper around the timing of the approval of network prices and the release of the final DMO determination.
- [43] In the event the AER is not able to approve network prices in time for inclusion in the DMO final determination, it is vital the AER use the best information available. We propose that the AER use the network tariffs contained in the network pricing proposals submitted for approval.

#### **Recommendations**

- Given potential data limitations, that network costs continue to be based on flat rate network tariffs.
- Support the use of final approved network prices. Where this is not possible, the AER should use the network tariffs contained in the network pricing proposals submitted for approval by 21 May 2025.

## 5. Environmental costs

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