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Wednesday, 19 December 2018

Mr Rod Sims
Chairman
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601

Dear Mr Sims

**RE: ACCC monitoring of electricity supply in the National Electricity Market – Discussion Paper**

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the ACCC Discussion Paper on the monitoring of electricity supply in the National Electricity Market.

**About ERM Power**

ERM Power is an Australian energy company operating electricity sales, generation and energy solutions businesses. The Company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load[1], with operations in every state and the Australian Capital Territory. A growing range of energy solutions products and services are being delivered, including lighting and energy efficiency software and data analytics, to the Company's existing and new customer base. The Company operates 662 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland. www.ermpower.com.au

**General Comments**

ERM Power has been supportive of the work undertaken by the ACCC and welcomed the recent final report into the Retail Electricity Pricing Inquiry (REPI). The REPI has given valuable insight to the industry which is facing numerous challenges as it transitions.  The report was produced from one of the most comprehensive reviews into the cost drivers of the industry to date, with the ACCC gathering information from participants and various other market bodies. Importantly, the REPI has given a picture of clear deficiencies in the small customer market, with some customers facing poor outcomes, enduring many years of price increases and obstacles in accessing the benefits of competition.

The REPI has rightly identified that price increases have stemmed from across the supply chain – from network tariffs to state and national environmental schemes, to a tight supply-demand balance in the wholesale market and even questionable tactics by some retailers. What has also been demonstrated, is that the Commercial and Industrial (C&I) market differs significantly from the residential market in terms of contracting and marketing practices, sophistication of the parties and the margins available to retailers; margins in the C&I sector are modest. There are lessons for residential retailing in the C&I retailing market, particularly with respect to price and billing transparency and the use of independent comparisons or assessment of offers. In the case of the C&I market, this is commonplace with brokers independently assessing offers in the interests of their customers.

[1] Based on ERM Power analysis of latest published financial information.

ERM Power has brought price competition and exceptional service to the C&I segment of the market. As a leading large market retailer, we understand the significant differences of this segment to that of the residential and small business mass market and strongly believe the ACCC needs to recognize these differences as it explores and scrutinizes the prices, competition and impacts of policy decisions.

In its monitoring, we believe the ACCC should focus on the areas of greatest concern highlighted in the REPI, being:

- the marketing practices of some retailers that dissuade small customers from engaging in the competitive market which has led to poor customer outcomes and the entrenchment of the large gentailers' incumbent base;
- the level of concentration in the market with vertically integrated retailers holding substantial portfolios of generation and customers, and impacts being further exacerbated by the tightening of supply and demand, due to the change in supply mix, fuel costs and the exit of large coal-fired generators; and
- market structure and power - evidence of a lack of competition in the setting of wholesale prices or where competitive forces are weakened or undermined as a result of Governments' intervention; such as the long-term risks stemming from the Queensland Government's direction to its own generator, Stanwell Corporation, to place downward pressure on wholesale prices.

On the first point above, we suggest further monitoring and reporting be made through a standardised 'comparison rate'-style small customer report, with full cost breakdown of unbundled charges to help demonstrate the true difference and movement in prices of different retailers and tariff structures. In the case of network charges, which are regulated, there should be no difference between retailers. Therefore, this would provide greater transparency around reporting and monitoring of the retail energy charges component.

On the latter two points above, we would expect monitoring to include a forensic review of transfer pricing between generators and their associated retail arm to ensure profitability of vertically integrated businesses can be adequately examined and assessed against the long-term benefits of consumers.  This analysis will be particularly valuable for accessing the impact of the Queensland market structure, given the two largest state government own generators, Stanwell and CS Energy together account for 66 per cent of capacity and 74 per cent of output[2]. For these Queensland generators, it would also examine whether or not their associated retail arm has leveraged off their government owned arrangements in the expansion into retailing, even into other states, which may provide only a short-term price benefit to customers but at a long-term detriment to competition. It would monitor the degree to which the taxpayer funded compensation for the Community Service Obligation transferred to the government owned corporation (GOC) is conflicting with the normal discipline of commercial decision making and stifling competition. It would also examine whether government owned participants are contributing to lower investor confidence, through operating and making decisions on a non-commercial basis.

If there is evidence of an impact to competition, we would expect the ACCC to work with the Queensland Productivity Commission to fully audit GOCs to investigate if they are compromised, operating against the principles of the competitive neutrality policy, and whether GOCs are operating with unfair advantage, resulting in inefficient production and pricing practices.

ERM Power believes monitoring of contract market liquidity should be undertaken, particularly where market changes threaten to further deteriorate liquidity and competition. Changes such as the commencement of the Five Minute Settlement rule, generator closure, any policy implementation surrounding emissions obligations, or a Retailer Reliability Obligation that may coexist with inadequate market liquidity obligations placed on gentailers should be thoroughly monitored for detrimental impacts to liquidity and competition.

[2] Wholesale electricity market performance report, AER, December 2018, page 19.

Throughout its monitoring activities, we believe the ACCC should consider these critical areas in examining the efficiency of the market in the long-term interests of consumers. It is for this reason we hold the view that the assessment framework should look to the achievement of the National Electricity Objective and National Energy Retail Objective.

We urge the ACCC to carefully consider the impact on the compliance costs to retailers and ultimately to the customer in determining any monitoring reporting requirements. Retailers have faced considerable increased regulatory compliance obligations with a plethora of new indicators for statistical reporting to existing regulators, including jurisdictional bodies such as the QCA. Any further imposition of reporting indicators has additional costs on retailers to develop systems, processes and resource staff to accommodate them. Ultimately increasing the regulatory obligations of participants comes at a cost to consumers, at a time when costs pressures are particularly felt across the industry. The ACCC needs to utilize existing data, prudently limit the need for new reporting indicators based on imperatives and avoid making any data requests that have a speculative or uncertain value.

The following pages provide responses to questions in the Discussion Paper.

[redacted]

Yours sincerely,

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Managing Director and CEO

ERM Power Limited

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| 1) The appropriate analytical framework(s) for the ACCC's monitoring activities, including<br><br>(a) What frameworks are most relevant to the electricity market<br><br>(b) How the ACCC should incorporate these overarching frameworks into its monitoring activities | 1)(a)<br><br>We note that the ACCC has suggested 3 potential analytical frameworks being:<br><br>• a market failure framework,<br><br>• a legal framework and<br><br>• a distributional/ equity framework.<br><br>The latter framework focuses on 'fairness and equity' which necessitates a broader subjective social value judgement. It is our view the ACCC should adhere to the Terms of Reference and provide an objective analysis on prices and whether prices reflect the efficient costs of energy and service provision.<br><br>(b)<br><br>We believe that the assessment criteria should be a measurement with regard to the National Electricity Objective and National Energy Retail Objective given industry development including regulatory change has always used these objectives as a measure of achievement of economic efficiency in the long-term interests of consumers.<br><br>Long term perspectives are important. As per AEMC's 'Applying the energy objectives' guide, "*changes that may be in consumers' short-term interests may not be in their long-term interests if those changes undermine incentives to make efficient investments and operational decisions over time. Generally, making changes specifically to provide customers with short-term price decreases at the expense of enabling investors to recover a return of and return on efficient investment will not be in the long-term interests of consumers*"[3].<br><br>It is imperative that any framework used to make an assessment has a long-term lens. That is, whether market structures, policy changes and participant behaviour support an efficient market and the long-term interests of consumers. Efficiency assessments should also consider dynamic efficiency and whether the market is flexible to support on-going changes in technologies and the transition of supply sources. |

[3] Applying the energy objectives, AEMC, 1 Dec 2016 page 6.

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| 2) Current overlapping and inconsistent methodologies to market monitoring, and suggestions for preferred approaches. | Rather than replicating or providing an inconsistent approach, in the first instance the ACCC should consider data available through existing market monitoring, including that of the AER and AEMC and AEMO. This would include information from the AER Wholesale Electricity Market Performance Reports, electricity reports, competition reviews, Retail Performance Reports as well as relevant reviews by other agencies. In the case of the former, valuable information has been analysed in the AER Wholesale report, including an assessment of competition, market power and liquidity. We urge the ACCC to monitor and further examine findings in this report. |
| 3) Which retail price data collected and reported on in REPI (as set out above) was insightful and should be produced on an ongoing basis as part of the monitoring function.<br><br>4) Is there retail price data not reported on in REPI that would be useful to understanding how well the retail market is functioning? | Consistent with the findings of the REPI, priority of focus should be on mass market, small customer price analysis. The REPI report's cost stack information was useful to illustrate the various cost components of small customers' bills. We suggest the ACCC should consider other opportunities for continuing to provide transparency around costs components of small customers. Further, reporting by mass market retailers should allow for retail energy charges discernible from network and environment charges. In the case of network charges, which are regulated, there should be no difference between retailers. As part of the monitoring, we suggest a standardised 'comparison rate' style customer should be made available with full cost breakdown of unbundled charges to help demonstrate the true difference in prices between different retailers and tariff structures. |
| 5) Are there different approaches to the analysis of REPI or other data that would be more useful than the analysis reported in REPI? | ERM Power believes focus should be placed on small customers outcomes where greatest deficiencies have been observed in the REPI. |
| 6) The best way to measure the relationship between wholesale and retail prices over time, including: | For retailing, focus should be on mass market/ small customer segment where the greatest distortions to the competitive market are currently being seen. Retail pricing data is available through publicly accessible sources and through Energy Made Easy.<br><br>On the wholesale market, data is available through the Australian Securities Exchange (ASX) and the Australian Financial Markets Association (AFMA) |
| (c) How wholesale prices affect retail prices and the ways in which this can be measured | |
| (d) What types of monitoring or analysis would best reveal the relationship between wholesale and retail prices | |

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| 7) What types of data are necessary to undertake this analysis | surveys (that have recently recommenced). AEMO collects vast data on the sector, particularly with respect to its work on the Electricity Statement of Opportunities. |
| 8) Analysis of the wholesale market that the ACCC could produce to complement the existing work of other agencies monitoring wholesale prices. | |
| 9) Analysis of retailer and generator profitability. In the case of wholesale profitability, what analysis could the ACCC produce to complement existing work monitoring generators or retailers? | For listed companies, financial statements should provide sufficient information. |
| 10) What methodology should the ACCC use in its approach to monitoring hedge contract markets? Are there specific metrics or pieces of information that are not currently reported that would be informative for market participants and policy makers? What types of data or information would be most valuable, and who should they be sought from? | As mentioned above the AER has recently released its wholesale performance report. Further sources of derivative trading information are available through the ASX and for OTC, through AFMA surveying. |
| 12) How an efficient electricity market can be expected to operate. | As we mentioned above, measurement against the NEO and NERO should be made. The ACCC should investigate whether the market is operating in an efficient manner in the long-term interests of consumers. Are market structures continuing to have a detrimental impact despite policy and has regulatory change been ineffectual or misdirected? Has participants behaviour, such as Government invention or ownership continuing to have a detrimental impact to competition in the longer term? |
| 3) What specific measurements or thresholds of market outcomes or participant behaviour should be used in the ACCC's electricity market monitoring? | Monitoring and observations should be made surrounding the compliance to the 'bidding in good faith rule' – 3.8.22A of the NER, a rule ERM Power supported.<br><br>Adherence to any market making obligations or market liquidity obligations of large vertically integrated retailers. ERM Power has always maintained that liquidity and competition is paramount for the market to sustain efficiencies and the long-term interests of customers.<br><br>In the case of Government owned entities, transfer pricing analysis and profitability would provide guidance on whether structures are having a longer term detrimental impact on competition. In the case of Queensland, though structural change may occur through the addition of another Government owned |

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| | corporation, is ownership itself, or, are there interventions into commercial decisions that are creating distortions to competition and the long-term interests of customers? Monitoring must examine these potential issues. |
| 14) What policy issues are likely to impact on the functioning of the electricity market and should therefore be a focus of monitoring by the ACCC? | ERM Power has consistently outlined the risks involved with a shift to five minute settlement with respect to contract markets, implementation costs, wholesale and retail electricity prices and generator availability[4]. We suggest the impacts from the Five Minute rule implementation should be monitored, particularly implications to the contract market and participants' ability to manage market risk with the likely increase to the costs of hedging arrangements.<br><br>Similarly, any implementation of the Retailer Reliability Obligation should be monitored closely, given the importance of market liquidity and competition in allowing smaller retailers to manage the risks.<br><br>Retailers have faced a barrage of new rules recently. It is important that the ACCC gives due consideration to the compliance costs of meeting new policy and rule changes, as they are likely to be passed through to customers in terms of higher retail electricity prices. This should not be understated for those retailers that have a small retail base to spread these costs. |
| 15) What methodological approaches could be undertaken by the ACCC in monitoring the impact of particular policy developments? | As stated above, policy developments should continue to be tested against the NEO and NERO. It is critical that policy changes be assessed on their impact to market liquidity and competition and whether the changes are such that gentailers are unfairly advantaged in managing the risks. Importantly policy development should not provide a path to further concentration through providing advantages to gentailers and making it hard for small retailers to compete effectively or providing a barrier to new entrants. |
| 16) The proposed reporting schedule and how it may affect your business. | Depending on the extent of data requests, retailers may need to be given up to 2 months to prepare. Any data requests should purely be made around gaps or |

[4] See ERM Power's submission to the AEMC's Five Minute Settlement draft determination and draft rule change https://www.aemc.gov.au/sites/default/files/content/afc5f4d5-cc59-4b8a-a30e-a2ec66e8d644/ERM-Power.PDF

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| | to verify anomalies. Should data requests be required, we would prefer a format of indicators rather than providing copious amounts of information that would then needed to be sorted through by the ACCC.<br><br>All information requests have operational /compliance costs for provision. ERM Power urges the ACCC to ensure the regulatory burden from this monitoring activity is kept to a minimum to avoid onerous administration and regulatory costs. |
| 17) Other similar reporting requirements your business is subject to, and the degree to which the ACCC's monitoring activities could align with those requirements (or information could be shared between agencies to minimise duplicative requests). | As previously described there is a plethora of regulatory reporting obligations that retailers must currently adhere to. We suggest the ACCC looks to utilising data provided to jurisdictional regulators, green scheme administrators and regulators such as the CER, AEMO and other market bodies, before making data requests. |
| 18) Whether particular measurements are likely to be more suitable for the March or September report, given the time of year those measurements are typically produced by your business, and the time required to finalise and collate that information. | Any data requests that cover the financial quarter ending 30th June effectively coincides with a busy period at the end of the financial year, particularly meeting other regulatory reporting obligations. Further March covers a very busy period around mandatory green scheme reporting. Proving retailers with adequate notice will be helpful in managing reporting. |
| 19) Factors that may impact the proposed schedule of information requests and reports, such as other regulatory obligations at similar times. | |
| 20) For information that needs to be requested from market participants, whether any information can be effectively captured via voluntary requests. | For C&I retailers, most of the information should be available through public reporting, and we support the concept of voluntary requests. |
| 21) Any relevant issues regarding the timing of reporting such as the value of certain information being available at certain times of year. | Data provision should not unnecessarily impede the efficient operation of retailers.  We believe 2 months appears to be a reasonable timeframe for provision of data. We suggest that the ACCC works to ensure it minimises data requests sought through information notices and relies on Energy Made Easy, Vic Energy Compare, publicly available information and regulatory data to the greatest extent possible. |