17 November 2017

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

Dear Mr Sims

RE: PRELIMINARY REPORY ON ELECTRICITY PRICING INQUIRY

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Competition and Consumer Commission's (ACCC or the Commission) Preliminary Report into electricity supply and prices.

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. ERM Power also sells electricity in several markets in the United States. The Company operates 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland. www.ermpower.com.au

General Comments

ERM Power supports the comprehensive work done by the ACCC so far investigating the drivers of increases in retail electricity prices in the National Electricity Market over the past several years. The Commission's findings would come as no surprise to our customers who have endured several years of seemingly ever-increasing prices.

Large energy users constitute about 60 per cent of electricity consumption in Australia. The sector is critical to jobs and the nation's economic prosperity and it's in all of our best interests to find ways to help them reduce costs and grow their businesses. As the ACCC will no doubt have found in its research so far, the residential electricity market is significantly different to that of the C&I market in terms of the way electricity is contracted. It is also vastly different in relation to the margin earnt by residential retailers versus commercial and industrial retailers, with significantly higher margins in residential retailing.

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

ERM Power brought competition to the C&I market and has championed solutions to reduce electricity consumption and cost reductions for business. This is evident in our modest margin and in our customer satisfaction which is the highest of any retailer (six years in a row) and this year, was the highest customer satisfaction score in the 21-year history of the UMI survey.[2] We would not record these outstanding levels of customer satisfaction at a time when prices have been rising, if we did not have the customer's best interests at heart.

ERM Power has interpreted the Preliminary Report as suggesting that there are no easy answers to what has been driving electricity price increases, and similarly, no easy solutions to stopping these. The cause of these price rises stem from right cross 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.

On the whole, competition has brought benefits to both the wholesale and retail segments of energy markets. Provided that competitors can operate on a level playing field and that new competitors are able to enter the market, competition should continue to benefit consumers in the long term. That is not to say that energy markets are working perfectly at present. There are definite improvements that can be made that would ultimately improve outcomes for consumers. The ACCC has highlighted some of these in its report. It is clear that ongoing scrutiny is required.

The proposed National Energy Guarantee will have to be carefully designed and involve close monitoring by the ACCC as it poses a very different market structure, one which, on the outset, tips the balance of power further in favour of generators, and even more so to those which are vertically integrated (gentailers). We believe the ACCC will have a significant role to play in designing the NEG.

The submission which follows provides more discussion on the ACCC's findings and how ERM Power believes markets can be improved to deliver better outcomes for all energy users: households, small and medium enterprises (SME), and commercial and industrial businesses.

I welcome the opportunity to discuss this submission in detail. Alternatively, please contact Regulatory Affairs Policy Advisor Ben Pryor on (03) 9214 9316 or BPryor@ermpower.com.au.

Yours sincerely,

Jon Stretch

Managing Director and CEO
ERM Power Limited

[2] Customer satisfaction refers to the Utility Market Intelligence (UMI) surveys 2011-2016 of large customers of major electricity retailers in Australia, undertaken by independent research company NTF Group

Wholesale markets

The sharp rise in wholesale market prices over the past 12 months certainly appears shocking. There are, as noted by the ACCC, a range of reasons for this increase including the closure of Hazelwood and Northern Power Stations and higher gas prices. Through the reduction in low-cost coal-fired generation capacity, gas is becoming the marginal fuel source more frequently, which due to high gas prices means higher wholesale prices. It is also important to remember that these rises have come after a long period of historically low wholesale prices, driven by an oversupply of capacity in the wholesale market coupled with falling demand. Neither of these situations would be sustainable over the long term.

ERM Power considers that policy uncertainty is likely preventing any meaningful new entry into the market. Until a climate and energy policy such as the National Energy Guarantee is finalised and implemented with bipartisan support this is likely to continue. It may also continue if states such as Victoria and Queensland continue to push ahead with their own schemes to support renewable energy. The threat of a new government-owned coal plant being constructed in Queensland pending the results of the state election will also act as a barrier to any private investment in that state above and beyond the challenge of competing with two dominant, government-back generators.

Increased competition in the wholesale market is crucial to improving outcomes for consumers over the longer term. As noted by the Commission, in each NEM region the combined market shares of the two or three most significant generators exceeds 70 per cent on both capacity and dispatched energy measures. In NSW, Victoria, and SA the dominant players are large, vertically integrated gentailers.

In order to provide the greatest benefits to the market, new generation should also be capable of participating in the contract market. Retailers (and generators) rely on contract markets to hedge risk in the wholesale market. When liquidity tightens, retailers either face higher prices to hedge, or may choose to hedge less, which translates to a higher risk profile. A higher risk profile requires higher returns. In either case, a reduction in contract market liquidity will lead to higher prices for end users.

Over the past few years, there has been significant new supply enter into the NEM, but as this has predominantly been wind and solar PV, they are unable, based on current technology, to offer hedge contracts to the market. An improvement in contract market liquidity is crucial for retail electricity prices to reduce.

Furthermore, we share the ACCC's concerns about falling liquidity in the contract market over the past few years. As we argue above, the increase in wind and solar PV capacity, along with the exit of plant such as Northern and Hazelwood power plants has partly prompted a reduction in contract market liquidity.

As flagged by the ACCC, the high degree of vertical integration in the NEM may be another driver of the reduction in contract market liquidity. In ERM Power's view, care should therefore be taken to avoid policy responses that may further enhance the market power of large, vertically-integrated gentailers, which could further reduce contract market liquidity. Policies such as the AEMC's Five Minute Settlement rule change, for which the Commission provides qualified support, may have the unintended outcome of further enhancing the market power of large, vertically-integrated energy business rather than increasing competition as some have indicated it will.

This situation certainly has the potential to threaten competition in the retail market by these dominant players not offering sufficient hedging contracts at competitive terms. In the case of Queensland, the two largest generators are government-owned; the Queensland Government's recent decision to direct one of their generators to lower their pricing has had flow on impacts to private generators in the market.

We are encouraged by the ACCC's statements that it will investigate options to address the concentration of market power in the wholesale market through options such as unwinding previous consolidation of generation assets, constraining further consolidation of ownership of existing generation assets and improving the availability and affordability of gas. A genuine increase in competition and associated increase in contract market liquidity should help to reduce wholesale electricity prices efficiently over the longer term, with overall benefits to consumers.

Retail markets

ERM Power shares the ACCC's concerns about the anti-competitive natures of retailers' strategies to avoid losing customers. Such tactics can include saves, whereby the losing retailer contacts the customer before the end of the 10 day cooling off period to offer a non-widely available offer in order to retain the customer. Another tactic is the 'win-back' strategy where the former retailer contacts the customer shortly after the transfer has taken effect with an improved offer to induce the customer to switch back.

In a very narrow perspective, this appears to be a good outcome for the customer: they receive a better offer from the retailer which enables them to save money. However, taking a wider look at the impact of these kinds of strategies on the whole market would indicate that while the individual customer may save money in the short term, there is a long-term cost imposed on retailers.

This is because for smaller retailers, particularly new entrants, there is a cost attached to acquiring a customer who may then be lured back to one of the dominant, large players after just a few weeks or months. This creates higher costs for which are in turn passed on to all consumers.

Larger retailers, particularly those which are vertically integrated, are more capable of absorbing these increased costs due to their economies of scale. Smaller retailers however find this more difficult and as such are pushed out of the market, to the overall detriment of competition and consumers.

ERM Power agrees with the ACCC that these strategies may in part a response to regulation within the sector. Any change to regulation will lead to retailers responding in a way to comply with new regulations; this will not always be in ways expected by regulators or policy-makers. As such, care must be taken to ensure that any changes implemented as a result of this review do not result in perverse outcomes.

Given the ACCC's criticism of win-back strategies is framed around maintaining a competitive playing field, and that the Commission advocates for boosting competition in the retail market, ERM Power wishes to draw the Commission's attention to the Victorian Government's recently commissioned review into retail energy markets.[3] The review panel made several recommendations which would fundamentally transform the retail energy market in Victoria in a way that is unlikely to significantly damage competition.

ERM Power considers that while some of the recommendations are sensible shifts for the market, the headline recommendation of re-introducing a regulated price, dubbed a 'basic service offer', is likely to be broadly negative for Victorian consumers over the long term. If implemented in the manner

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[3] Thwaites, Faulkner & Mulder. *Independent Review into the Electricity & Gas Retail Markets in Victoria*, August 2017

described in the review, the basic service offer is likely to set prices at a level that will only allow the incumbent, dominant retailers to operate economically in the market. This could destroy competition, harming consumers over the longer term. The Victorian Government has not yet issued a formal response to the review's recommendations. Nonetheless, we encourage the ACCC to engage with the Victorian Government to highlight the risks of the review panel's recommended approach.

The ACCC's preliminary report also notes that:

> *"a number of peak industry bodies for small to medium commercial and light industrial sectors have called for greater transparency of pricing including more detailed bills (breaking down peak and off peak consumption, retail charges, environmental schemes, network charges)".*[4]

ERM Power already breaks down bills into these constituent parts for C&I customers in order to increase transparency. Increased transparency in pricing helps to show consumers the impact of different cost drivers on electricity bills allowing them to see the impacts of different policies or decisions. In the case of network charges, which are regulated, there should be no difference between retailers or retailer strategies. Therefore unbundling these charges at the very least would help demonstrate the true difference in prices between different retailers and tariff structures. There may be a case for this to be expanded to other customers including SMEs and residential, though it will be important to balance the greater granularity of information with simplicity, particularly for small customers.

Retailer and environmental costs

The ACCC has found that retailer costs have increased significantly since 2007-08 and that there are differences in costs between states due in part to differing regulation across the NEM regions. ERM Power agrees with the ACCC that differences in state regulation are a key component of higher retailer costs. While the National Energy Customer Framework (NECF) was designed to be a consistent national approach to energy regulation, in practice this has yet to eventuate. States have opted out of aspects of the Framework leading to different thresholds for issues such as the definition of small customers, and in the case of Victoria, there is a completely separate retail customer framework.

The lack of consistency leads to multiple reporting and compliance obligations which creates higher costs for retailers. This also includes complying with state-based green schemes. At present ERM Power must comply with four different state-based energy efficiency schemes in Victoria, New South Wales, the ACT and South Australia. Each has a separate reporting, compliance and auditing process and each requires different forms of procurement to comply. This results in a significant and costly regulatory burden. Ultimately these costs are passed on to consumers. While it sits outside the scope of the ACCC's powers, a national approach to energy efficiency, such as a single harmonised scheme, would help to reduce retailer costs which would consequently help lower retail energy prices.

ERM Power supports the ACCC's comments on the impact of environmental schemes on electricity prices in particular for solar PV. The combination of upfront support from the federal government via the Small-scale Renewable Energy Scheme combined with generous feed-in tariffs that would provide long-term support, led to a surge in solar PV uptake. This has resulted in costs that have ultimately been passed on to all consumers, many of whom were in no position to install solar PV. While these schemes are closed to new entrants, there is still a legacy impact in most states. We acknowledge the

[4] ACCC, 2017, *Retail Electricity Pricing Inquiry – Preliminary Report*. p 22

Queensland Government's attempt to address the long-term costs of their own Solar Bonus Scheme by taking the costs on budget rather than recouping these from electricity bills. This is a positive step.

In considering climate change policy, a single, national scheme with bipartisan support and a clear goal is needed in order to create a suitable environment to allow long-term generation investments to occur. This is the only way to obtain the lowest-cost approach to get affordable, reliable and cleaner electricity.

The Australian Government has proposed the National Energy Guarantee (NEG) as a means to meet this goal. ERM Power considers that this certainly has the potential to achieve this, but it will depend on the detail of the policy. In particular, care must be taken to ensure that the NEG does not further enhance the market power of the existing dominant gentailers. Although there is limited detail available at present, ERM Power sees a number of risks with the NEG that could lead to enhanced market power at the expense of smaller players in the market. Another key element of the policy design will be to ensure that the price of both reliability and emissions is transparent to participants. This will help consumers to understand the impacts of the policy on electricity prices as well as allowing investors in the sector to factor in the expected value of being a low-carbon or dispatchable generator when deciding on what kinds of investments to make. We encourage the ACCC to contribute to the design of the NEG to ensure that the final policy does not harm competition in either the wholesale or retail electricity markets.

Network costs

As the ACCC has noted, one of the major drivers of electricity price increases has been network costs which have increased significantly over the past few years. Unfortunately this is the one element of the supply chain where the ACCC is least able to influence. That said, the recent removal of the Limited Merits Review may help to reduce future network cost increases in the long term.

In addition, ERM Power is actively working with customers to examine their network costs and find ways to lower the network component of their bills. This includes our 'Demand Alerter' service which automatically sends customers text messages or emails notifying them in advance to take action to keep their maximum demand below the peak demand target. This helps organisations to monitor and control their energy more effectively, and reduce their network demand charges.

Additional comments

The ACCC's preliminary report focusses on residential customers, but also helpfully examines the impacts on SMEs and C&I customers. The C&I market in particular differs significantly from the residential market in terms of contracting, sophistication of the parties and the margins available to retailers. As noted by the commission, margins in the C&I sector are modest. Although some of the issues affecting electricity price rises for residential and C&I customers are similar, ERM Power considers that the ACCC needs to recognise the differences between the two sectors as it explores potential solutions.

As such, we encourage the ACCC to continue to engage with industry as it examines options to help reduce electricity prices for consumers. It is crucial that any solutions are appropriately targeted so that they achieve their aims without producing perverse outcomes. ERM Power would be troubled by any solutions that may reduce competition in the wholesale or retail market for example.