



21 December 2015

Economic Regulation Authority
Level 4, Albert Facey House
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Perth WA 6000

Submission By Email to: publicsubmissions@erawa.com.au

RE: Discussion Paper 2015 Annual Report to the Minister on the Effectiveness of the EGRC Regulatory Scheme

ERM Power Limited (ERM) welcomes the opportunity to respond to the Discussion Paper 2015 Annual Report to the Minister on the Effectiveness of the EGRC Regulatory Scheme.

About ERM Power

ERM Power is an Australian energy company that operates electricity generation and electricity sales businesses. Trading as ERM Business Energy (EPW) and founded in 1980, we have grown to become the fourth largest electricity retailer in Australia, with operations in every state and the Australian Capital Territory. We are also licensed to sell electricity in several markets in the United States. We have equity interests in 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland, both of which we operate.

General Comments and 2014 Review of the EGRC Regulatory Scheme

ERM agrees with the recommendations made in the ERA's 2014 Report to the Minister on the effectiveness of the EGRC Regulatory Scheme (Scheme). ERM is disappointed that the Government has not acknowledged and adopted the recommendations made by the ERA in the 2014 report.

Our understanding was that the intention of the Scheme was to ensure a level of competition was not compromised by the re-merger of Synergy and Verve, by ensuring that Synergy did not preference its own retail and generation arms, which was the State Government's publicly stated position.

Adoption and implementation of the recommendations would have led to an improved level of competition, more in line with what has existed for many years now for commercial and industrial customers in all other states.

The Minister for Energy criticised the findings of the 2014 review citing that the ERA should have conducted the review based on data rather than interviews with private participants. Given the comments made by the Minister for Energy and now that the ERA is in its second year of conducting this review, the ERA should request any and all data it requires from Synergy and

analyse the information specifically to determine whether Synergy's activities did or did not contribute to distortions in the market and how well the regulations are working to achieve the Government's stated objective.

A lack of transparency around a forward price curve for the market has also led to allegations of misbehaviour (potentially predatory pricing and or misuse of market power) by Synergy. It is these issues which the Scheme needs to address to enable sustainable and strong competition in the WA electricity market.

Approach and focus for the 2015 review

The ERA's Discussion Paper (Paper) outlines two areas of foci which the ERA would like to undertake further work in the 2015 review, a review of the level of competition in the wholesale and retail markets and the Standard Products regime. In assessing these particular areas, the ERA will consider the level of the playing field and confidence of Market Participants.

In line with the ERA's foci in the 2015 review, ERM considers that there are certain elements which need to be examined in the ERA's review of the level of competition in the wholesale and retail markets and to provide confidence to market participants. These elements include:

- the level (and almost complete lack of) of transparency that exists around the TAP,
- Substantiation of recent annual price changes in all contestable tariffs that are within the Franchise segment and figures of load and customer number in this category (including L3 and R3).
- Whether unmetered supplies are also included in TAP supported tariffs and if so, what the cost justifications of these are. Many unmetered supply connections are contestable elsewhere, including to councils etc and in turn ratepayers.
- share of deals won by Synergy since the merger (by GWh and customer segment as well as number)
- In assessing the deals won by Synergy its important to compare the underlying wholesale price used for retail transactions compared to the SPA of the day, as well as the actual price offered.
- Comparison of the underlying wholesale price used for retail transactions compared to prices quoted by the Wholesale Business Unit to other retailers during the same period
- appropriate transfer pricing principles between Synergy's Wholesale and Retail businesses, and
- increase transparency around the segmented reporting requirements around Synergy with the potential to go as far as reporting by market segment in the retail space.

Related to the above review of the level of competition in the retail and wholesale market is the issue of market share. The Minister for Energy recently indicated that over the last 4 years, Synergy's share of the contestable market has decreased by 28%. It is not clear what metrics have been used to calculate the decrease in market share as it could be a reference to any number of measures including but not limited to electricity volumes or number or customers. The ERA in its analysis of the level of competition has to ensure that there is a clear definition of market share and in doing so, it should then be able to request the data required for its analysis from Synergy.

The lack of transparency around how the large and increasing TAP is calculated and which customer segments the TAP has been used to subsidise leads to a lack of confidence in the market.

Transparency around the TAP would provide confidence to the market (and the broader community) that there is no cross-subsidisation from the residential (Franchise) segment to any other non-Franchise business segments, contestable (also Franchise) or non-contestable.

Related to the issue of the TAP is segmented reporting. The Franchise market segment (ie customers using <160MWh of electricity per annum) is comprised of three types of customer classes, ie residential customers and both non-contestable and contestable (50-160 MWh) businesses who are all able to be on Synergy tariffs.

ERM understands that Synergy is currently the sole supplier of electricity in the residential and also non-contestable business market segment, but also a major supplier (however no figures are available) in the Franchise contestable customer segment of 50-160 MWh. The TAP is potentially used to subsidise all these market segments, which is not widely understood and to date has not been reported on in any meaningful detail.

Improved and clarified reporting of the key customer classes, ie contestable customers, non-contestable Franchise customers, unmetered supplies and residential customers will lead to increased confidence around the issue of cross-subsidisation and also allow the Government to better identify and decide the specific customers where the TAP is warranted.

The issues around appropriate transfer pricing provisions between Synergy's wholesale and retail businesses relate to providing market confidence in the structural model of a wholesale price being offered to a retailer, who in turn resells the product with a margin.

If there is a breakdown in this process whereby the retailer consistently resells or attempts to sell the product at a price that is lower than the wholesale price, the market becomes significantly distorted and logically this is not a sustainable way for a business to be run (unless the businesses are being funded from elsewhere). This structural integrity is core to ensuring the fundamentals of a functioning market and has been significantly compromised since Verve and Synergy were re-joined.

Standard Products Arrangement (SPA)

ERM has operated in the WEM Retail environment for five years and its experiences in the WEM are markedly different to that of its experiences in the other States of Australia. ERM in the 2014 review made an observation that the SPA sets the wholesale benchmark that electricity retailers use to price retail customers.

The SPA was intended to be a "price discovery mechanism for competitively priced wholesale electricity" by providing "transparency and predictability". It sets the view of the forward price curve for the WEM. The fact that only 14 transactions have occurred since its inception is clear evidence that the SPA is not working as it was explicitly intended to.

ERM reiterates its view in the 2014 review that the Standard Products price-board does not appear to be used as the basis for pricing retail customers and therefore it can only be concluded that the SPA in its current format has failed. This failure is either due to the SPA price book being

too expensive or Synergy (and potentially other retailers) selling at a long-run loss or potentially short via the Balancing Market.

ERM welcomes the ERA's intention to review the SPA arrangements and make improvements. However if retailers, Synergy included, do not use the SPA as the basis of the forward curve then the review may not result in changed market behaviours nor will it lead to increased competition due to the absence of a functioning forward price curve. If this scenario eventuates, a new mechanism has to be introduced that could provide some forward price signals that could be used by all Market Participants in a non-discriminatory way.

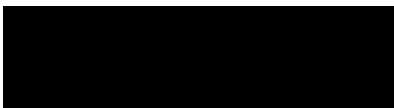
Conclusion and Potential Improvements

ERM has previously made the suggestions that the Government amend the regulations to ensure that Synergy's retail arm is sourcing supply from the wholesale arm to ensure no distortions in the market. ERM still believes that the regulations should be changed to ensure that Synergy retail always seeks a price from wholesale and that price should be made available to other retailers. This should improve transparency in the market and will certainly reduce any potential for misuse of market power.

Another possible improvement that the ERA could look at to improve the SPA regime and to provide a measure of transparency is to ensure that Synergy Retail contracts a portion of energy from the SPA for its contestable customer base. If Synergy is contracted at SPA prices for a portion of its contestable customer base this ensures that the SPA is utilised and it should also ensure that SPA prices are competitive and not expensive as they currently are.

If the ERA would like to discuss the content of this submission further, please contact Wendy Ng on 08 6318 6416 or email wng@ermpower.com.au.

Yours sincerely,

A black rectangular box redacting the signature of Steve Rogers.

Steve Rogers
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ERM Business Energy