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Jodi Willcox
Director, Shareholder Policy and Markets Branch
Department of Treasury and Finance
21 Murray St
Hobart TAS 7000

Dear Ms Willcox

RE: Wholesale Electricity Market Regulatory Pricing Framework Options Paper

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Wholesale Electricity Market Regulatory Pricing Framework Options Paper prepared by Energy Market Consulting Associates (EMCa) for the Tasmanian Department of Treasury and Finance (DTF).

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 load¹. 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

Of the six presented options, ERM Power sees only the first three options as being in any way viable and practical to achieve the government objectives while still allowing competition and an efficient market.

The degree of intervention in the final three options, particularly 5 (Fixed Mandatory Contracts) and 6 (NEM Trader), would remove all competition from the Tasmanian retail electricity market, and the removal of competitive pricing for generators may discourage new entrant build, and efficient signals of when this is required. This is clearly highly disruptive to efficient market operation, and would act to further discourage new entrants to both the supply and retail sides of the market.

To be effective at meeting the government's price objectives, options 4, 5, and 6 rely on the assumption that the Wholesale Reference Price will always be below the unregulated wholesale price. Any Tasmanian customers on regulated tariffs would not gain any advantage from downward price movements, as their cost would be fixed, regardless of moves in the wholesale market. Backwardation in forward electricity contract prices as new generation is forecast to come online implies prices will be cheaper in the future.

That said, Options 1, 2 and 3 are not without issues of their own.

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



Discussion of Individual options

While option 1 (status quo) is clearly the least disruptive, the current mix of rebates, government intervention and price caps is complicated, and stifling efficient market operation. The current rebate scheme is convoluted, difficult for our customers to understand, complicated to administer and requires expensive auditing.

Option 2 (Refined Rebates) has the benefits of no direct market intervention; all price control occurs outside of the wholesale market. This promotes efficient market outcomes, retail competition and adds no additional barriers for new generation or retail entrants. Furthermore, there remains potential for customers to benefit when wholesale prices drop, with the rebates acting to cap high prices, rather than lock in a fixed rate.

However, rebate schemes are cumbersome to administer which ultimately increases costs to customers. As said above, the current scheme is convoluted, difficult for customers, complex to administer, requires expensive auditing and ultimately is an ongoing reminder of failed market structures to all customers. Equally, the intent of the rebate is to protect customers from high energy prices yet they are still required to pay these prices with a compensatory claim after the fact. This potentially imposes a financial burden on the customer as they still have to carry the costs of the energy premium for a period of time, until funds are rebated.

Option 3 (Capped Wholesale Contract Regulatory Instrument), removes the need for rebates and the associated issues that come with that, by capping prices at the wholesale level. Wholesale Contract Regulatory Instrument (WCRI) contract prices would be capped at the Wholesale Reference Price, so this option allows for customers to benefit from lower prices, with high prices limited by directly capping the contract prices. Generally, as with any market intervention, this option would have an adverse impact on market efficiencies and investment price signals. More specifically, this option raises issues about the use of the WCRI as an effective hedging tool, and as a price basis for customer offers, given the lack of price validity and uncertainty in volume given the scaling rules.

This was exemplified during the Basslink outage period when prices were well above WCRI levels. When WCRI prices are well below Hydro Tasmania's Rate Card offerings, demand means the WCRI contracts are over-subscribed, the total offered volume is reduced, and the volume offered to each wholesale customer is determined via the scaling rules. This inhibits the ability to buy adequate amounts of contracts to hedge retail sales at these lower levels, and hence pass on reduced pricing to customers.

Under current scaling rules, which are based on percentage of current Tasmanian small customer load, Aurora Energy has an unfair advantage, as their incumbent position and associated size provides them with disproportionate allocations of hedges. This further entrenches Aurora Energy's dominant position and stifles competitors and new entrants. In this way, current scaling laws are highly inefficient, as they are based on existing customer volumes, rather than the volume of new customer load.

WCRI pricing offers are only made available during a two-hour window once a week. This lack of any meaningful validity period makes it virtually impossible to use WCRI pricing as an effective basis for customer offers. As a retailer, to effectively hedge customer offers priced off the WCRI you must (a) buy what volume you think you will be successful in winning (limited by availability/scaling rules), (b) hope that WCRI prices in the next offering will not be materially different, and (c) presume that sufficient volume to hedge new customer load will be available. With the WCRI in its current form, it is not clear that capping the price of the WCRI contracts would efficiently flow into the desired savings for consumers.

The Hydro Tasmania Rate Card remains the primary basis for the wholesale component of customer offers. The certainty in volume and validity period make it a much more effective source of wholesale pricing, and source of hedges for new load. Options 2 and 3 have both positive and negative outcomes – customer rebates mean no market intervention, but are costly and complex to implement, while capping wholesale prices is easier to implement, but distorts the market, and may not deliver the intended outcomes.



ERM Power's preferred approach

ERM Power envisions a combination of Options 2 and 3, which utilises rebates to limit market distortion, but from the customer's point of view, applies price caps at the wholesale level. Our preferred approach is one where Hydro Tasmania would offer contracts as they do now, with prices not capped in anyway, and set by the market, system costs, opportunity costs, etc.

However, when Hydro Tasmania sells a hedging swap contract to a retailer, if the Hydro Tasmania wholesale rate is above the Wholesale Reference Price, the contract between the retailer and Hydro Tasmania is set at the lower rate based on the Wholesale Reference Price. Hydro Tasmania would then apply to the Tasmanian Government for a rebate, to recover the difference between the wholesale price and the reference price. This allows the retailer to offer customers pricing based off capped wholesale prices, with certainty on available volume, while still retaining efficient market pricing signals, and not limiting competition.

In times of high pricing (such as during the Basslink outage), customers see the benefit immediately, rather than carrying the additional cost before receiving any rebate. Hydro Tasmania still retains control of volume they sell to retailers, limiting any potential market arbitrage. As the rebate scheme is now only between Hydro Tasmania and the Government, this would significantly reduce the complexity of implementation, and pricing would be transparent for all customers.

Conclusion

If Options 1, 2 or 3 are selected as the preferred approach following this review, then in order to retain any form of meaningful retail competition within the electricity market, changes must be made to the WCRI scaling rules.

Retailers must be offered access to equal volumes under the WCRI to facilitate a level playing field. For example, if a 5MW maximum limit existed each week under the WCRI, and there were 5 active retailers, then each retailer must be given access to a minimum of 1MW under the instrument each week.

We propose these improvements to the regulatory framework as they promote the Government's objectives, while furthering retail competition, and have the least impost on customers and minimise market distortion as much as possible.

Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

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