



Our Ref 121009 AEMC Power of Choice Stage 3 DSP Review Draft Submission.docx

11 October 2012

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Attention: Eamonn Corrigan, Director

Dear Sir,

RE: Power of Choice – Stage 3 DSP Review

Thank you for the opportunity to make a submission in relation to the draft report, Power of choice – giving customers options in the way they use electricity dated 6 September 2012.

ERM Power Retail Pty Ltd is an electricity retailer that specialises in large business customers as defined by the energy consumption thresholds in the various jurisdictions, generally referred to in the draft report as C&I customers. This submission relates specifically to those customers and the implication of the proposals in the draft report as they relate to retailing electricity to those customers. As noted in your draft report, these large customers already enjoy both access to more detailed usage information and time of use tariffs for both energy and network services.

We would like to draw the AEMC's attention to the current commercial and market practices where there is strong competition for C&I customers on the basis of the energy tariffs and cost of environmental obligations and that network charges are generally "passed through".

The following remarks are set against the AEMC's stated goal of "*addressing the incentives needed for network operators, retailers and other parties to maximize the potential of efficient DSP and respond to the consumers' choices, in a manner that minimized the total cost of electricity services*"

Given that the typical C&I customer's price is expressed in terms of separated energy, environmental and network charges, it is most efficient to consider the proposed changes in the draft report against each of these categories of costs.

Energy

In the highly competitive C&I retail market the cost of energy reflects closely the wholesale price of energy, which has fallen steadily in recent years. Figure 1 shows the trend in wholesale electricity prices from 1999 to date.

It can be seen from this that the current costs of wholesale energy and by extension the retail cost of energy are at an all time low. Similarly volatility in the market is also at an all time low. In 2012/13 the cost of electricity has increased but only as a result of the Commonwealth carbon pricing scheme.

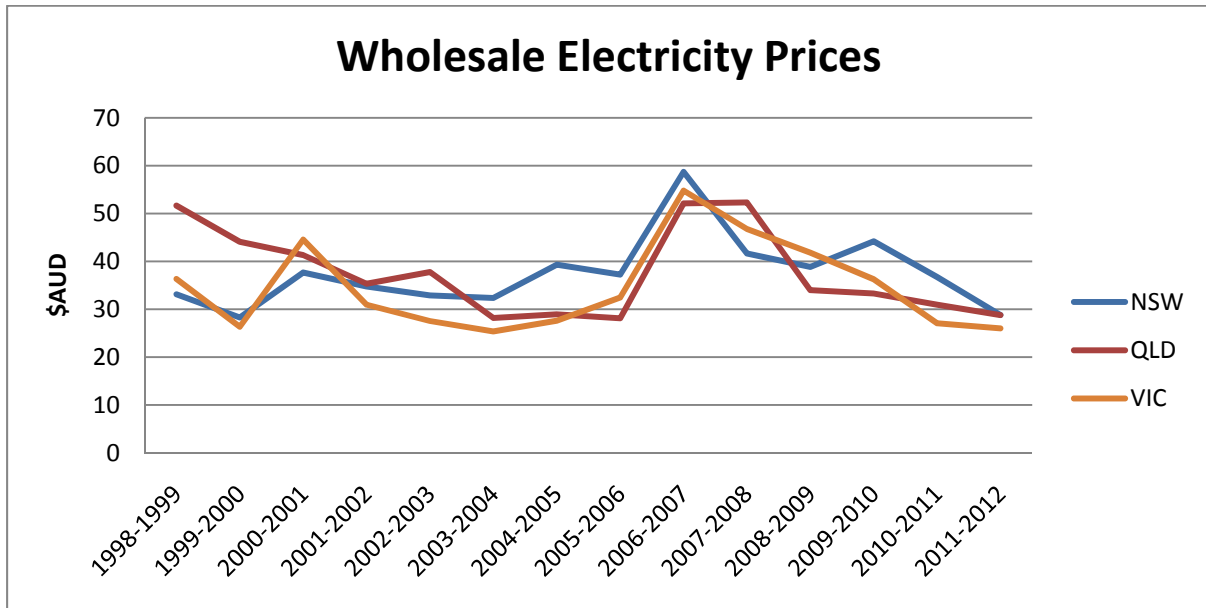


Figure 1 - Wholesale Electricity Prices

Section 1.2.2 of the draft report and Figure 1.7 refer to an increase in electricity tariffs of 37.2% from 2010/11 to 2013/14 of which 40% is due to increases in the wholesale cost of electricity. This information is for residential tariffs and is certainly not reflective of reality in C&I tariffs which have fallen or remained flat between 2011/12 and 2012/13, when the cost of carbon is excluded.

In the executive summary the draft report says “*DSP also reduces the costs incurred by the electricity supply chain in meeting consumers’ needs in aggregate. This can exert downward pressure on electricity prices*”. As shown above the retail cost of energy to C&I customers is already at an all time low and we see no reasons to expect that the proposed changes in relation to DSM would exert any downward pressure on prices or indeed result in a reduction in the prices paid by C&I customers. On the contrary, we consider that the additional complexities proposed will have the opposite effect and that they will exert upward pressure on the retail cost of energy. The addition of additional risks to be managed, technologies to be installed and reporting and compliance will be recovered as usual from the users.

Consider for example EnerNOC’s proposals which show the operation of the proposed changes as a zero sum game. If this is indeed the case, then there is no real value created, but a raft of additional costs will be added for activities such as technology deployment, baseline measurement and verification, upgrades to retailer billing systems, DR notification systems and AEMO pre-dispatch upgrades. In addition to these additional costs, there is also the introduction of an additional participant in the supply chain who will expect to make a profit from their activities. As noted above the customers will ultimately pay more for these unnecessary changes.

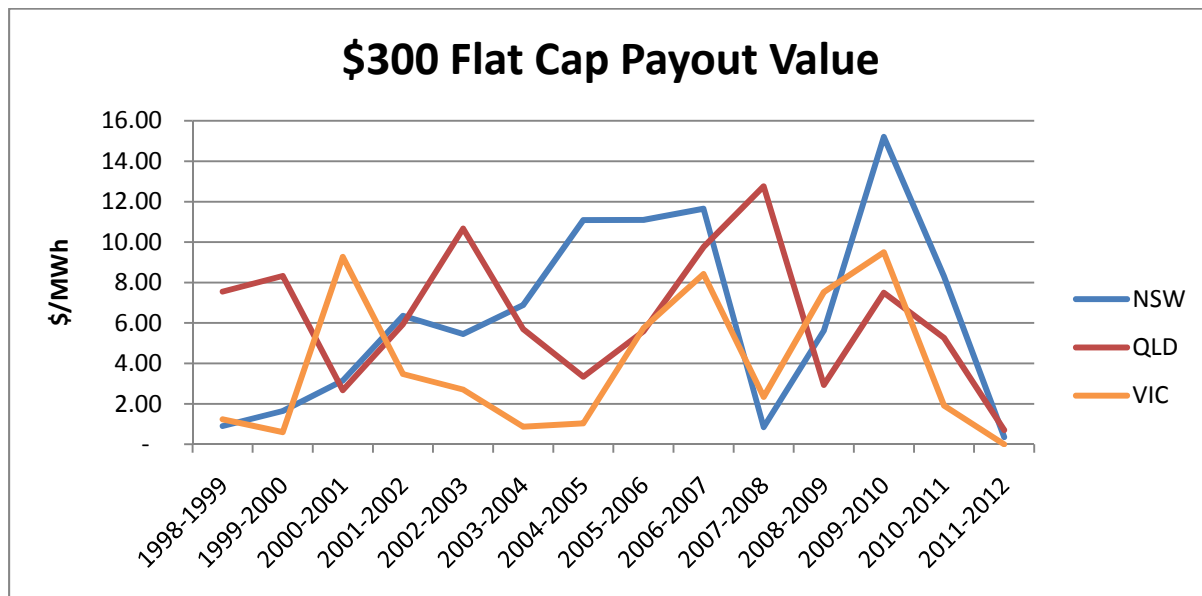
As stated in the draft report customers do not participate in the wholesale market (energy or demand response) directly, but engage with retailers to participate for them. ERM offers DSM options to its customers and it is our experience that the main reason why customers

do not take up DSM offers is because they value of their lost load more than the prevailing wholesale value of DSM. It is not our experience that customers do not participate because there is no DSM offering.

By way of an example, consider a C&I customer with an average electricity cost of 15c/kWh including energy, network and environmental charges with an annual consumption of 6,500 MWh and therefore an annual cost of \$975,000 for energy. If this customer has a load curtailment capability of 1 MW with a response time of 30 minutes then the average payout value calculated from the NEM data for Qld from 2008-11 would have been \$34,894/year and so far in cal 2012 would be zero.

Customers generally do not participate in the wholesale market for energy because a retailer offers then a superior outcome in terms of cost and reduces or eliminates their spot price risk. The same set of trading and risk management capability is required to participate in demand response as is required for energy trading. Given this it is highly unlikely that a customer would use a retailer to buy energy and then in parallel establish and maintain their own internal wholesale market trading systems to dispatch their DSM capability. Thus the only outcome of the proposed change is to encourage the entry of aggregators.

Figure 1.6 of the draft report shows the fall in demand in energy. Figure 1 above shows the coincident fall in energy prices which have been accompanied by a coincident fall in price volatility especially in the last 2 years as shown in Figure 2.



Both of these factors combine to reduce the payout

Indeed it is wrong and misleading to assert that:

- There are no efficient DSM products offered to C&I customers – ERM Power offers DSM products to all of its customers ; or

- That there are market barriers to uptake of DSM – the reason for customers not participating is that they value their production more highly than the wholesale market values demand/load reduction; and
- Retailers will not be worse off under the proposed model – retailers will incur additional costs which they will pass through to customers.

In addition to the above, the proposed changes will introduce complexity and additional risk to the generators and retailers including:

- Hedging requirements will become inefficient as retailers over-hedge to the baseline rather than the diversified load shape;
- Generators may not be able to run to cover contracted positions if DSM is dispatched first;
- Retailers will lose some of their ability to efficiently price variations in customer loads across their entire portfolio;
- DR participants (customers and aggregators) will be exposed to spot exposure above the baseline as will the retailers so this will be priced twice;
- DR participants (customers and aggregators) will be exposed to negative pool prices during an event. Recent experience in Queensland shows rapid price reversals.

In relation to the specific questions set out in the draft report our answer are as follows:

Q12(a). No, we do not consider that the proposed mechanism is likely to result in efficient consumption decisions by end users for the reasons set out above.

Q12(b). No new sub-category is required for registration of aggregated demand as there is no requirement for this service. If this sub-category was introduced it should be treated just like a generator with the same risk profile and prudential requirements as a generator.

Q13. No comment

Q14. No comment

Network Charges

As noted in the draft report, network charges have been rising strongly since 2008 and are expected to continue to rise with 34% of an expected increase of 40% between 2010/11 and 2013/14 being attributed to network charges. It is our experience that from 2011/12 to 2012/13 that network charges increased by an average of around 20%.

We note that much of the draft report discussion in relation to network tariffs applies to small business and residential customers who are not currently paying for the network service on a time of use basis. We agree with the draft recommendation that “*the distributions pricing rules in the NER are amended so that distribution network businesses have sufficient guidance to set efficient and flexible network tariff structure that support DSP*”. In addition to addressing the issue of DSP for customers on flat network tariffs, there is also a requirement

for transparent and clear incentives for large C&I customers already on time of use tariffs to participate.

At present, the NSPs run programs which are typically open only to select groups of customers or service providers such as aggregators who are selected by the NSPs. These programs are inconsistent in their application and structure and the NSPs are frequently dealing directly with customers in a manner which is confusing to both customers and other market participants.

We consider that the NSPs should run transparent and open DSP programs with the following features:

- Open and transparent pricing or bid/auction processes;
- Non-competition by NSP's contestable businesses;
- Open to participation by retailers, customers and aggregators

Metering

We are supportive of the draft report recommendations that relate to the provision of historical metering data to residential and small business customers. We consider that no changes should be made in relation to large (C&I) customers. We believe that retailers should be permitted to charge (or not charge) for all types of data at their discretion. We consider that any attempt to regulate this part of the market has the potential to stifle innovation in data provision.

ERM already offers information to its customers via an on line portal and we are aware that C&I customers can access data from all retailers without additional regulation.

Yours Sincerely,
ERM Business Energy

Matthew Forrest

Executive General Manager, Energy Solutions