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Energy service company perspective

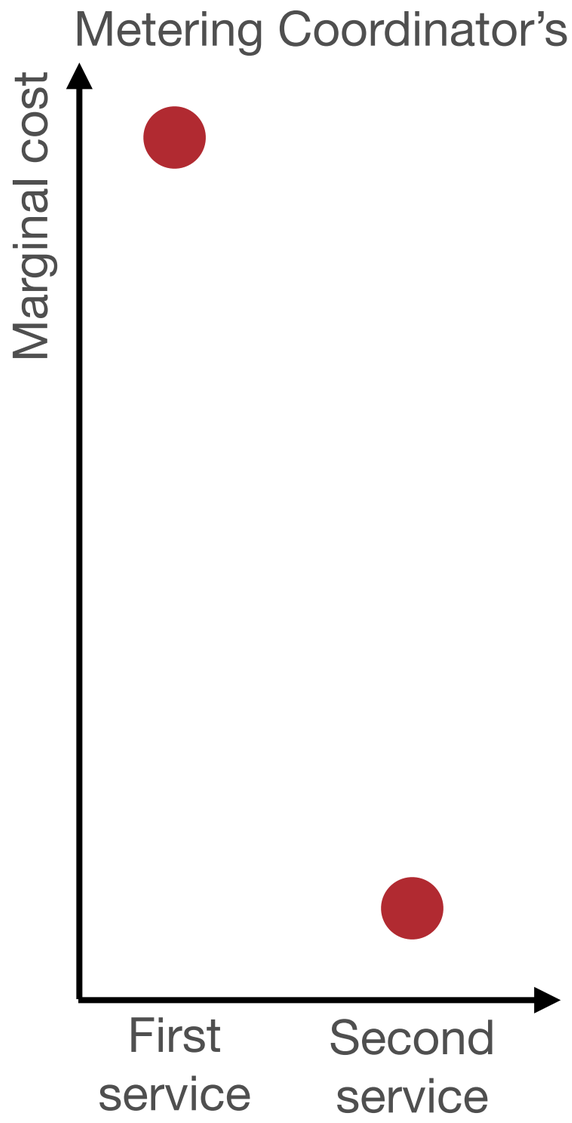
AEMC public forum on competition in metering and related services — Sydney, 30 April 2015

“Under the proposed model, Metering Coordinators (MCs) compete to provide services to the retailers who appoint them, while LNSPs must rely on whatever network services are offered by the retailer-appointed MC. Competition will drive MCs to offer the services that retailers value at an efficient price, but, once appointed, MCs will have no competitive pressure in relation to the provision of services to the LNSP.”

SA Power Networks submission, May 2014, p. 2.

This gives you a clue as to the likely dynamics of the market: whereas retailers and customers will be well served by the MCs who compete for their business, networks and third parties have no choice of supplier, so nobody will compete for their business.

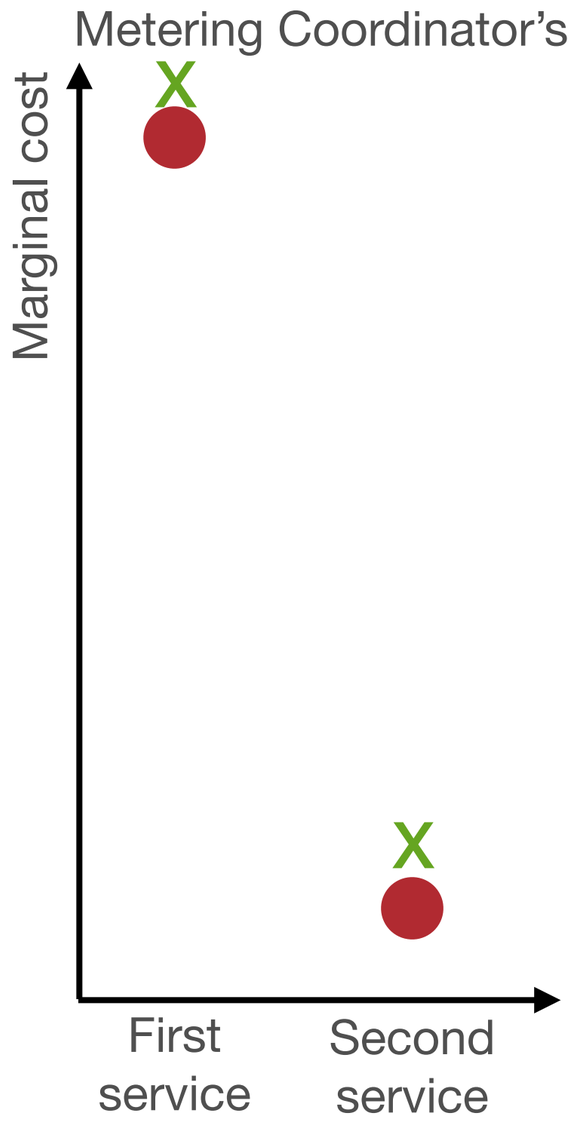
What does it cost to provide services from a meter?



Providing the first service from a meter is expensive: you need to pay for the meter, roll a truck (with an electrician) to install it, and maintain both the meter and connectivity to it.

The marginal cost of supplying an additional service from the same meter — e.g. giving an additional party access to data that is already being collected — is very small. A person from a metering firm described it as "near zero" this morning.

How are metering services likely to be priced?



In a competitive market, prices would be competed down to a little above marginal costs — e.g. these green crosses. This is viewed as an "efficient price". We can expect MCs' charges for their main service to retailers and customers to be close to this efficient price.

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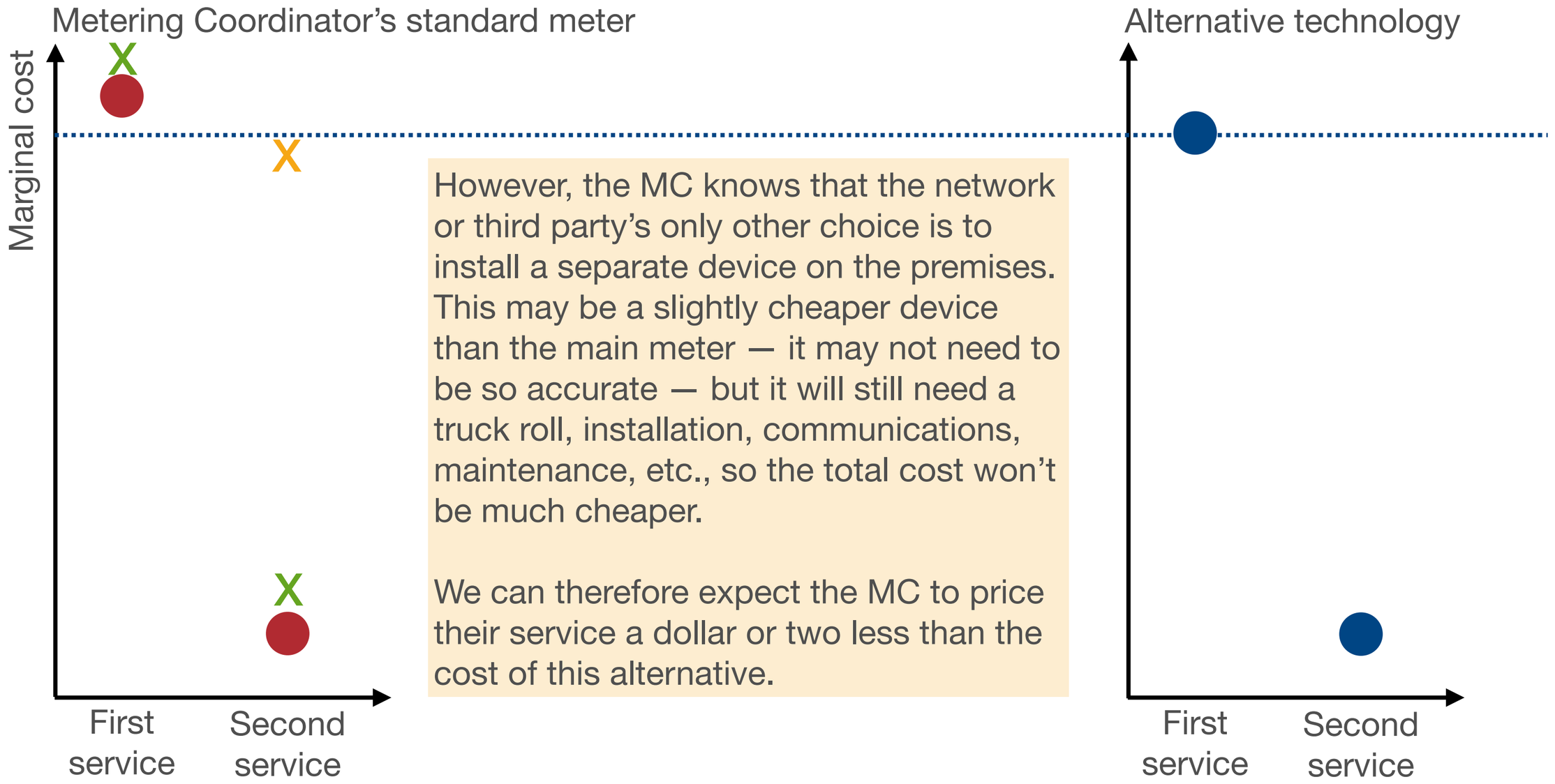

However, the MC knows that the network or third party's only other choice is to install a separate device on the premises. This may be a slightly cheaper device than the main meter — it may not need to be so accurate — but it will still need a truck roll, installation, communications, maintenance, etc., so the total cost won't be much cheaper.

We can therefore expect the MC to price their service a dollar or two less than the cost of this alternative.

What other businesses have these characteristics?

High fixed costs + Low marginal costs

⇒ Very large scale economies

⇒ Natural monopoly

It may seem odd to describe this situation as a monopoly. Normally this terminology is applied in situations where billions of dollars have been spent building some crucial asset. However, the competitive dynamics (or lack thereof) are exactly the same: essentially, there's a lot of small monopolies, with one MC being the monopoly supplier of metering services to networks and third parties for each premise.

This is just like a network business

High fixed costs + Low marginal costs

⇒ Very large scale economies

⇒ Natural monopoly

⇒ Need to protect consumer from exploitation of control of asset

⇒ Regulated access arrangements

You could argue that there's no real need to regulate network businesses, because their exercise of market power would be constrained by the ability of an access seeker to build their own poles and wires to reach the customer. But nobody thinks that's a sensible outcome. The same applies here.

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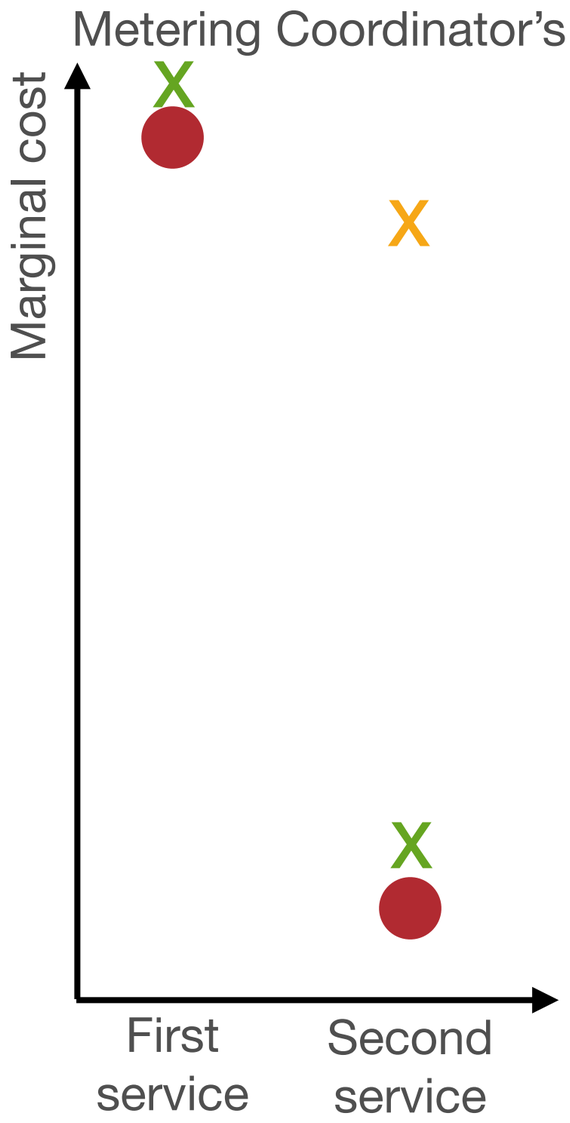
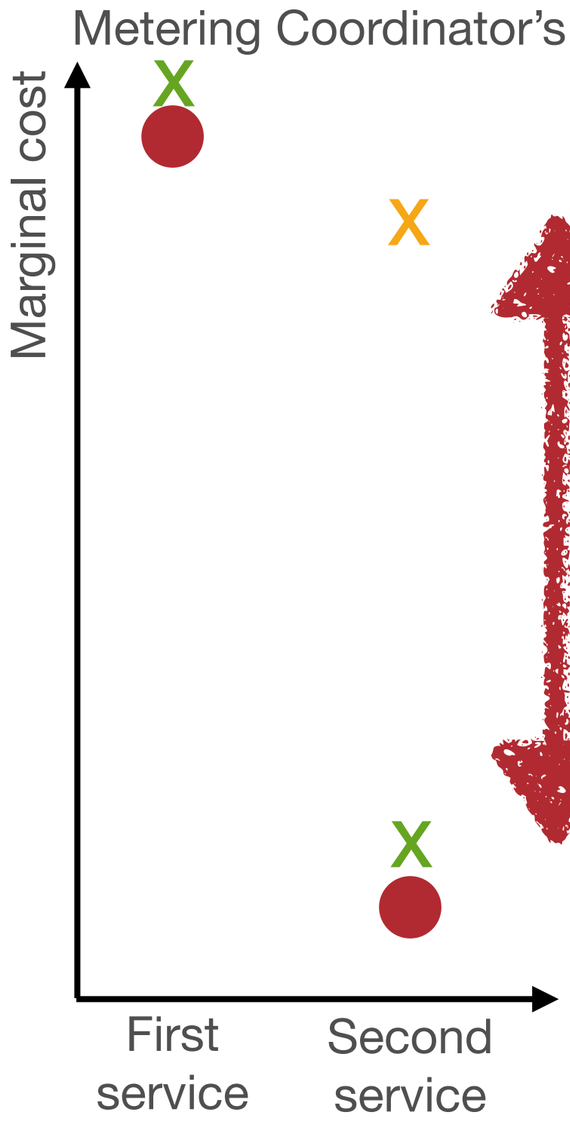
Efficient pricing of metering services



Retailer is paying this much

Why should a third party pay this little?

Efficient pricing of metering services



Monopoly rent

Customer ~~Retailer~~ is paying this much

Why should the customer pay for the meter again?

~~Why should a third party pay this little?~~

It would not be a good outcome for the customer to end up paying rent on the meter several times over.

“Regulators know that when left alone, a profit-maximising monopoly produces less of the good or service than is desired by society and at too high of a cost.”

Principles of Microeconomics, Unit 10
Jay Kaplan, University of Colorado

This is textbook economics. In this case, the profit-maximising behaviour of the monopoly suppliers of metering services will lead to consumers having less choice of energy services, and paying over the odds for them.

Everything I've mentioned so far applies equally to networks and to third parties.

But it's even worse for third parties

“Where there is a vertical relationship there will be a clear incentive for the Retailer Metering Coordinator to provide access in a way that enhances the competitiveness of its retailer owner or closely affiliated retailer in the retail market.”

“The Metering Coordinator may have an incentive to deny or frustrate access for use of its functionality and data.”

Draft determination, pp. 266-267.

So a retailer can have both the motive and the opportunity to frustrate access by third parties. In fact, the MC doesn’t have to be controlled by the retailer for this problem to arise: even where there’s an independent MC, a retailer may be willing to pay more for a service that includes frustration of third-party access than for a service that allows open access. This wouldn’t be a good outcome.

The draft determination lists four reasons why the exercise of market power by MCs may not be a serious problem. The only one of those that applies in the case of access by third parties is that the customer could change retailer.

But that's a very big ask. It's like the tail wagging the dog. Customers choose retailers on the basis of their retail deals, not on the basis of how friendly they are to third parties.

Even if a third party could persuade a customer to change retailer, having to wait for each customer's retail deal to expire (or pay their exit fee) before they can start providing a service is likely to hamper market entry to such an extent that third parties might decide it's not worth it.

So the listed reasons not to worry about market power are unfortunately unconvincing.

Customers choose retailers for their energy deals

Principle

"If a new entrant has to negotiate with an incumbent, who views them as a competitor, for access to a customer, you won't get new entrants."

"self-evident"

This can't be a new observation. I assumed it must be well known — maybe the "zeroth law of competition". So I asked a couple of economists whether there was some eminent economist I could quote who'd said something like this. Their responses were "it's so obvious that no eminent economist has bothered to write it down", and "it's self-evident".

Solution is light-handed, limited-scope access regulation

- Don’t need to regulate most relationships.
- Only need to regulate where the buyer has no choice of supplier.

It’s not necessary to regulate an MC’s core activities — namely competing to provide metering services to retailers and customers. That’s where the vast bulk of their revenues, costs, and profits should be. Regulating their interactions with other parties therefore shouldn’t increase investment risk for MCs (unless their whole business model is predicated on extracting monopoly rent from multiple parties…)

Dr Paul Troughton

Senior Director of Regulatory Affairs

+61 404 522 002

ptroughton@enernoc.com

www.enernoc.com.au