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Mr Mark Feather
General Manager, Policy and Performance
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Mr Feather

RE: AER Position Paper Default Market Offer Price

ERM Power Retail Pty Ltd (ERM Power) welcomes the opportunity to respond to the AER's position paper on the Default Market Offer Price (the Paper).

About ERM Power Retail

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]. 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.

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General Comments

ERM Power understands that the proposed Default Market Offer (DMO) would apply to residential or small business customers who do not take up a market offer for the provision of retail services and whose standing offer is of a tariff type for which the AER determines a DMO price. It is the intention that a DMO price will be determined for each distribution zone in those jurisdictions where price regulation does not exist.

The aim of the DMO is that of a safety net, not as a lure to existing market customers. Its purpose should be to form the basis of a transparent benchmark, ensuring those retailers engaging in discounting practices refer to a consistent platform, reducing customer confusion around actual discount levels. We welcome and support the objectives of the DMO for this purpose. ERM Power also generally supports the AER's top down approach in the Paper as being the most sensible and achievable methodology considering the compressed timeframe for the DMO price to be set.

ERM Power believes the setting of the DMO price needs to be well analysed and cost reflective to minimize the emergence of distortions in the competitive market from the imposition of price regulation. It would be concerning if the DMO price is set at a level that does not realistically price risk and operational costs of retailing, as ultimately customers may be persuaded to disengage with the competitive market. If the settings are such that the DMO attracts existing market offer customers at unsustainable levels, the impact to the competitive market could be devastating and this would be detrimental to the long-term interests of customers with restriction in choice, innovation, product diversity and the entrenchment of the large gentailers' incumbent base.

We provide the following response to a number of the questions posed in the Paper:

Question 3: For small business customers, what type of tariff structures should be subject to a DMO price? Should there be different types of tariff structures subject to a DMO price in different distribution zones? Please provide reasons for your preferred approach.

We note that the AER proposes to have the DMO price to apply only to flat rate tariff structures for small business customers. ERM Power supports the AER's flat tariff-only approach, being the most reasonable and achievable. That is, we support a proposal to have a DMO price for flat tariffs only, and other non-flat tariff types continue with the current approach which is to have the tariff priced to a level at the discretion of retailers. To be clear, any attempt to use a DMO flat tariff bill outcome to determine the level by which other non-flat tariffs can be priced or compared would be unfeasible, not cost reflective and would lead to customer detriment. There are inherent difficulties in segmenting business customers into discreet consumption groups due to the diversity in business operations and therefore energy use, even at a small customer level. We support the AER's approach to have the DMO apply only to flat tariff customers and believe this to be the most sensible given the complexities in accurately forecasting small businesses time of use and demand structures and the greater likelihood of estimation errors for this group.

It is our view that any small business reference bill should also be limited to flat tariff structures due to the difficulties in segmenting this group and the likelihood of misleading customers through generalizations about usage estimates that must be made to create it. Though limiting the use of the reference bill to flat tariff customers, we would encourage the AER to consider other opportunities for retailer price comparisons of small businesses, through allowing greater transparency in the presentation of offers, with retail energy charges discernible from network and environment charges. In the case of network charges, which are regulated, there should be no difference between retailers. Therefore, for presentation and reference bills, unbundling these charges would help demonstrate the true difference in prices between different retailers and tariff structures.

Question 7: For small business customers, are the proposed upper and lower thresholds reasonable, given the policy intent? If a more targeted upper threshold was used, which retailers standing offers should be included? Are there any offers or categories of offers that we should not include as inputs into our proposed methodology? Should the range be the same in each distribution zone? Please provide reasons for your preferred approach.

Most standing offer customers of second tier retailers are on this contract type as an interim arrangement (deemed contract). According to retailers' obligations, customers must be placed on a deemed/ standing contract if the customer has not entered into a market agreement. This circumstance presents for 'move in' customers yet to consider market contracts whilst customers transfer out to another retailer, or when the customer has failed to enter into another market agreement at the expiry of their contract. In ERM Power's case, only a small number of our customers are on standing contracts and overwhelmingly these customers are on this deemed arrangement for a short period of time.

For second tier retailers, the uncertainty around the duration and the transient nature of the deemed arrangement places a different procurement risk profile on these customers compared to those that have entered into long term market contract arrangements. The situation is also quite different to the instance of standing offer customers of large incumbent retailers that have a significant proportion of their customer base who have never engaged in the competitive market and have been on standing offers for a long time. Many of these incumbent retailers have greater certainty to the quantum of standing offer load and can manage the hedge risk with their vertically integrated arrangements. When determining the upper band of the DMO price, we believe that all retailers standing offers must be considered in the calculation, rather than just a subset of incumbent standing offers. This will reduce the likelihood of the DMO being set at a level that will only allow the incumbent, dominant retailers to operate economically in the market.

Similarly, when setting the lower band, we suggest that only unconditional market offers be included in the analysis. Conditional offers are usually tailored to customers with distinct attributes and are less likely to be reflective of customers on general deemed arrangements.

Question 9: For small business customers, on what basis should we set the consumption benchmark as part of our proposed methodology? Please provide reasons for your preferred approach.

Given the time constraints, we agree with the AER's proposal to look to publicly available information such as the Energy Consumers Australia (ECA) data and note that AEMO should have relevant data that may assist in forming flat tariff consumption benchmarks for small business customers.

Question 13: What should be the duration of the AER's DMO price determination? Please provide reasons for your preferred approach. To what extent and under what circumstances should there be scope to reopen the AER's determination?

The dynamic nature of the sector with the transition of energy supply, policy uncertainty which has amplified regulatory risk, and the costs from rampant piecemeal regulatory change, makes setting tariffs accurately incredibly difficult and the idea of 'efficient' levels becoming less and less clear. Although the AER approach seems generally sound, in determining forecast costs for the 2019-20 period we urge the AER to consider the dynamic market retailers are currently facing and the long-term consequences of getting the settings wrong. Policy developments such as the National Energy Guarantee/ Reliability Obligation or any future potential climate change policy including the costs of emissions reduction may quickly place the DMO at uneconomic levels. We believe this current environment warrants the DMO to be flexible to account for material changes that may impact retailers' underlying costs. In the current environment, a 12-month setting appears to be long and we suggest that a 6-month review for material cost changes would be necessary.

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

Yours sincerely,

[signed]

Libby Hawker

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