



Friday, 8 March 2019

Dr Kerry Schott
Chair
Energy Security Board

Dear Dr Schott

RE: ACCC Retail Electricity Pricing Inquiry Recommendation 1

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Energy Security Board's (ESB) consultation on recommendation 1 from the Australian Competition and Consumer Commission's (ACCC) Retail Electricity Pricing Inquiry.

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, with operations in every state and the Australian Capital Territory. 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 considers that the concentration of generation ownership in various NEM regions is having a damaging impact on spot markets and contract market liquidity. By extension, this is impacting retail market competition. This is harming consumers and will continue to do so unless reforms occur. The ACCC's Retail Electricity Pricing Inquiry final report made this clear.

Consequently, we broadly support the ACCC's proposed recommendation to prevent acquisitions that would allow an electricity market participant to own, or control dispatch of, more than 20 per cent of generation capacity in any NEM region or across the NEM as a whole.

We accept the proposal that this restriction should not prevent investment in new generation and that the cap would not apply to increases in a company's market share as a result of new investment. This will help the market deliver capacity when and where it is needed.

We also accept the view that the limit should not apply in the event of an acquisition by a party with no or a negligible existing market share in the NEM or a NEM region. Without the exemption, it may make it difficult for large-scale acquisitions or takeovers to occur as some generators would have to be split up before being sold off. This risks inadvertently reducing asset values and would also introduce additional risk to the electricity market at a time of already heightened risks.

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



However, ERM Power contends that this limitation needs to be enforced carefully to prevent participants from circumventing the rules via certain arrangements. In particular, we foresee that there will need to be a clear definition of when new investments count towards a market participant's market share. Box 1 provides an example of how the cap could be circumvented due to timing issues

Box 1

In a NEM region with 10,000 MW of capacity, Generator A has a market share of 10 per cent, or 1,000 MW.

Generator A decides to invest in a new 2,000MW of baseload plant. Once completed this would give them control of 3,000 MW of the now 12,000 MW in total capacity. Generator A would have a market share of 25 per cent which would prevent them from making further acquisitions.

However, before the new project has been completed, Generator A decides to acquire a 1,000 MW plant from Generator B. This acquisition would not be allowable following the investment in the new plant as Generator A would already control more than 20 per cent of capacity.

However, if the acquisition occurs before Generator A's new investment is included in its market share, it would ultimately control one-third of the capacity of the market (4,000 MW out of 12,000 MW).

Consequently, ERM Power considers that the ESB needs to carefully consider and design rules that specify when at what point in the investment timeline new investments will count towards a market participant's market share.

These rules will also need to be designed to prevent a similar problem such as if participants aim to 'contract up' by purchasing the rights to control dispatch of plants in advance of new investment in order to circumvent the cap.

We encourage the ESB in devising these rules, or the Australian Energy Regulator (AER) in enforcing them, to pay close attention to how contractual arrangements such as Power Purchase Agreements (PPA) or contracts for difference (CFD) are structured and apply to a participant's market share. Depending on the exact nature, these arrangements can give participants control over the generation and allow for the ability to influence outcomes in spot markets and by extension, in contract markets. In general, a PPA will give the buyer more control over the dispatch and pricing outcomes compared to a CFD where the buyer is largely a price taker. This distinction will need to be monitored carefully in assessing how contractual arrangements impact a generator's market share under this recommendation if implemented.

Treatment of non-dispatchable capacity

The consultation paper queries how investments in non-dispatchable capacity such as wind, solar and demand response. ERM Power agrees that it is not equitable to treat all capacity in the same fashion given they have very different characteristics. We consider that an administratively simple solution would be to align the treatment of wind and solar capacity with the firmness treatment that would apply under the Retailer Reliability Obligation (RRO).

Different structures within businesses will lead to differences in how generation from wind and solar can impact the spot and contract markets. For instance, the variability of wind or solar can be 'minimised' as part of a wider portfolio where other dispatchable technologies may be used to virtually 'firm' variable plant.

A consistent approach with the RRO would mean that participants could not simultaneously claim that variable plant is not dispatchable enough to enhance their market power under the ACCC Recommendation while also arguing that thanks to internal arrangements they are able to 'firm up' solar and wind for compliance under the RRO. A harmonised approach balances the opportunities and risks for generators and gentailers and limits the ability of those with a large market share to influence pricing outcomes in the spot and contract markets.

Demand response (DR) presents a similar but distinct challenge to variable generation such as wind and solar. For DR, there may be difficulties in determining what is new investment and what is simply contracting arrangements



for existing supply of DR capability. Setting this aside, ERM Power considers that demand response can provide for the control of embedded generation or reductions in load, and as such should be included in calculations of a generator's market share. This is especially important for vertically-integrated gentailers who control large volumes of generation and manage large volumes of customer load.

Conclusion

ERM Power cautiously supports the implementation of the ACCC's recommendation 1. We consider that care must be taken to devise rules that do not allow for the cap to be circumvented as a result of the timing of new investments and possible acquisitions. We also argue that aligning the treatment of wind and solar capacity with its treatment under the RRO will be an administratively simple way to include it within the scope of the 20 per cent limit.

Yours sincerely,

[signed]

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