2 September 2015

Richard Owens
Senior Director
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Owens

RE: MULTIPLE TRADING RELATIONSHIPS CONSULTATION PAPER

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) Multiple Trading Relationships (MTR) Consultation Paper (the Paper).

About ERM Power Limited

ERM Power is an Australian energy company that operates electricity generation and electricity sales businesses. Trading as ERM Business Energy and founded in 1980, we have grown to become the 4th largest electricity retailer in Australia, with operations in every state and the Australian Capital Territory. We are also licensed to sell electricity in several markets in the United States. We have equity interests in 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland, both of which we operate.

ERM Power was also a representative on the Australian Energy Market Operator's (AEMO) Multiple Trading Relationships and Embedded Network Reference Group, involved in the design and issues identification which formed the basis of AEMO's rule change request.

Multiple Trading Relationships

ERM Power does not support the proposed rule change. We believe that there is a weak value proposition both for retailers to offer MTR-dependent products and services, and for customers to contract for those products and services. Given MTR-like arrangements can be supported operationally today in the rare cases where they are required (predominately commercial and industrial sites) the key objective of this rule change request is to explicitly provide for these arrangements from a legal perspective. With low uptake for MTR-dependent arrangements expected, the significant costs associated with amending all national and jurisdictional instruments to explicitly support these are disproportionate to the benefits that may be gained.

Even if we have grossly underestimated the appeal of MTR-dependent products and services, this rule change request is unlikely to deliver net benefits to consumers. Customers with MTR-arrangements would be very costly to serve, and the expected operational costs incurred by retailers are only likely to increase with customer uptake. All retailers would face the risk that an existing customer could take-up an MTR-arrangement with another retailer, and therefore could not avoid the costs associated with supporting such customers. Further, the nature of these operational costs means that they cannot be materially

reduced by system automation or process efficiency. ERM Power therefore believes that regardless of the level of uptake, the costs associated with the proposed rule change request would outweigh the benefits.

In the submission that follows, we explain that:

1. the value proposition of MTR-dependent products and services is weak for both retailers and customers;
2. the operational costs of supporting customers with MTR arrangements would be high;
3. specific elements of the proposal would be particularly problematic; and
4. MTR-arrangements can be delivered under the current regulatory framework sufficiently to manage the rare cases where it is required.

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

Yours sincerely,

[signed]

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SUBMISSION TO MULTIPLE TRADING RELATIONSHIPS CONSULTATION PAPER

1. The value proposition of MTR-dependent products and services is weak for both retailers and customers

In its rule change request, AEMO states that its proposed changes will contribute to the achievement of the National Electricity Objective (NEO) and the National Energy Retail Objective (NERO) by increasing the range of competitive electricity products and services available to consumers. This statement assumes that there are commercial business models for products and services that rely on the proposed MTR arrangements being implemented, and that there is a sufficiently strong value-proposition for customers to drive material customer demand for products and services enabled by MTR arrangements. We explore these assumptions below.

1.1. Are there commercial business models for products and services that rely on the proposed MTR arrangements being implemented?

In determining the potential competition benefits of the rule change request, the Consultation Paper states that the Commission will consider whether the proposed MTR framework would facilitate market entry of new energy service providers.[1] However, it is our understanding that the proposed MTR design only allows authorised retailers to offer products and services to a customer under an MTR arrangement.[2] That is, the proposed arrangements do not provide a new avenue for a service provider to supply (or purchase) electricity to (or from) customers without acquiring retail authorisation. This means that the market entry of third party energy service providers would only be facilitated through the proposed rule to the extent that retailers choose to partner with them to deliver the retailers' products and services. Therefore, when considering the business models that may be supported by the proposed rule, the Commission should be focussing primarily on retail businesses.

Traditional electricity retail businesses rely on economies of scale. Because of the significant costs of establishing systems and processes to meet market and regulatory requirements, in addition to meeting prudential and credit support requirements, retailers seek to maximise the volume of electricity that is sold to (or purchased from) customers to access a stronger return on investment. This is also why large electricity users can generally access lower electricity rates than small users. While the market is now transitioning to a time where energy management services, including generation and storage, will increasingly be offered by retailers to attract and retain customers, this will not change the fact that contracting for a greater volume of electricity to a customer would be preferable to a lower volume.

In contrast, AEMO's proposal assumes that a retailer would choose to offer to sell or purchase a portion of a customer's load, rather than servicing their entire load. The only reason we can imagine that a retailer would make such an offer is if its strategy was to acquire small volumes from customers that it otherwise would not be able to win (i.e. a small volume is better than no volume from that customer). However, if the retailer is unable to make an offer that is sufficiently competitive with the incumbent offer for the entire load, it is unclear how reducing the volume would allow it to offer a more competitive offer. This would be contrary to the basic economies of scale on which retail businesses are built. For example, there are currently operating in the National Electricity Market (NEM) a number of retailers that bundle the sale of equipment and services with the sale (or purchase) electricity.[3] These retailers supply

[1] AEMC, *Multiple Trading Relationships Consultation Paper*, 30 July 2015, p.14
[2] AEMO, *National Electricity Rule Change Request – Multiple Trading Relationships*, December 2014, p.8.
[3] Examples include Pooled Energy (offering pool equipment, services, and electricity supply), Commander (phone and electricity supply) and Go Energy (solar financing, energy efficiency products and management services, and electricity supply).

electricity for entire premises, not just the electricity associated with their equipment. The absence of the proposed framework has clearly not been a barrier to entry for such business models.

We conclude that there is a weak value proposition for retailers to offer a product or service to customers that cannot be delivered without the proposed rule.

1.2. Is there a sufficiently strong value-proposition for customers to drive material customer demand for products and services enabled by MTR arrangements?

The AEMC engaged KPMG to explore the range of potential products and services that may be enabled by the proposed MTR framework, and the extent to which these are dependent on the framework being established. It identified nine products or services, each allowing customers to separately contract portions of their load or generation to different parties, in exchange for certain benefits.[4]

KPMG states that the value proposition for customers taking up these products and services would be determined through lower energy bills, environmental considerations and/or a more convenient, better quality service.

Generally, cost is the deciding factor for electricity decision-making. We acknowledge that some customers do choose to pay more to access environmental, convenience or quality benefits, but this is the small minority. This cost is not only about potential bill savings, but also about the capital cost to the customer on entering the arrangement. For example, only a very small proportion of consumers took up solar for environmental reasons while the costs of installing a solar system were high. However, as the costs reduced such that bill savings would pay back the capital cost within the expected period of residence at a property, take-up was more wide-spread. Similarly, we can expect only a very small number of consumers to purchase MTR-dependent products and services unless they can be demonstrated to lead to lower energy bills, such that the bill savings pay back the initial capital investment over a reasonable time period.

It is expected that all customers will face some capital cost on entering an MTR arrangement. This is likely to include the cost of installing an additional meter (or upgrading the existing one) and additional wiring.

In order for MTR-dependent products and services to lead to lower energy bills, they must either allow the customer to purchase energy at a lower rate (or sell energy at a higher rate), or to purchase less energy (or sell more energy), compared to if they were to contract just one retailer. As described above, it is not expected that economies of scale would allow a retailer to offer a more competitive rate for servicing just part of a customer's load. An MTR-dependent product or service could have the ability to reduce the volume of energy purchased or increase the energy sold by a customer, through providing a means of generation, storage, or load management. However, these products or services would have the same impact on consumption or generation as equivalent products offered by a retailer that services the customer's entire load.

Even if the impact to energy bills was neutral, it is expected that the upfront capital costs of entering an MTR arrangement would outweigh the environmental, convenience or service quality benefits for most customers. We therefore do not believe that the value proposition is sufficiently strong to drive material customer demand for MTR-dependent products and services.

[4] KPMG, New Energy Services and Multiple Trading Relationships, July 2015.

2. The operational costs of supporting customers with MTR arrangements would be high

Following the negative cost-benefit assessment undertaken by Jacobs SKM, AEMO was requested to revise the initial MTR design to allow more cost-effective options.[5] As a result, we can confirm that the MTR framework proposed in AEMO's rule change request is likely to have lower implementation costs than the initial proposal. However, the ongoing operational costs for servicing customers with MTR arrangements remain very high, and a retailer cannot avoid incurring these additional costs.

In section 3 below, we outline that subtractive metering configurations and certain approaches to network charging would significantly increase the operational burden and financial risk borne by retailers. However, even if our recommended approach to managing these aspects of the MTR design were adopted, the operational costs incurred to service customers with MTR arrangements would remain significantly higher than other customers. The following sections explain the operational costs in that context.

2.1 Customers with MTR arrangements would be more expensive to serve

Engaging more than one retailer at a customer's premises increases the complexity of the site's physical and financial characteristics, and therefore the complexity of the management of that site. Greater complexity means greater chance of errors (such as transferring or billing the wrong NMI, and assigning the correct network tariff). The more complex the site setup, the more likely the customer is to raise enquiries and disputes about their bills for each NMI.

In addition to an increased frequency of errors, enquiries and disputes, addressing each of these may be more challenging. The added complexity means that there would be more factors to consider, and investigating each factor may be more time-consuming. For example, resolution is likely to require a far greater level of communications between the other parties at the site (the distributor and the other retailer(s)). Such communications are not facilitated through market systems, instead relying on emails and phone calls. This makes them more difficult to track, and can prolong resolution.

While investing in more sophisticated system solutions may allow a retailer to reduce the frequency of errors to some extent, managing these tasks revolve around human interactions; that is, conversations between the retailer and customer or between the participants at a site. There is very little that a retailer can do to reduce these costs, which will ultimately be borne by customers.

2.2 Retailers cannot avoid the costs of servicing MTR customers

Where a retailer chooses to offer its customers an MTR-dependent product or service, the additional costs to serve these customers can be factored into the offer to ensure costs are recovered efficiently. However, where a retailer's existing customer is offered an MTR-arrangement by another retailer, the first retailer cannot avoid the increase in its cost to serve that customer. While the retailer may have contractual terms allowing it to renegotiate the offer, its obligation to supply that customer would remain.

Therefore, the implementation of the proposed MTR framework would require all retailers to make system, process and contractual changes, even if they had no intention to offer an MTR-dependent product to customers. Similarly, all retailers would face the risk of incurring the additional operational costs of servicing an MTR customer, when an existing retailer establishes MTR with another retailer.

[5] AEMO, p.8

The Consultation Paper states that "*retailers could voluntarily choose to adapt their systems to support specific kinds of MTR, where they perceived an economic value in doing so*", or that they may be able to adapt their systems over time.[6] It is true that retailers choose to manage some customer arrangements through manual processes where they cannot justify incorporating them into automated system solutions, and this may apply to some aspects of MTR customer management. However, the requirement to service some customers through bespoke manual processes still represents an additional cost which would not be incurred if MTR was not enabled. Further, there would still be a number of system and process changes that would not be discretionary, such as the basic requirement to identify whether a customer has an MTR arrangement or not.

3. Components of the MTR framework that would be particularly problematic

ERM Power does not support a change to the regulatory framework to facilitate MTR, for the reasons outlined above. However, if it was implemented, there are a number of elements of the proposed framework that would be particularly problematic, significantly increasing the implementation and operational costs of MTR.

3.1 Subtractive metering configuration

The rule change request identified three metering configurations that could support MTR: parallel, subtractive, and net metering. While parallel and net metering configurations are similar enough to existing configurations that they could be supported without major changes to our systems, subtractive metering configurations are significantly different.

ERM Power currently retails to a number of embedded network customers, which are subtractive metering arrangements for more than one customer. The cost to serve these customers is significantly higher than customers on the NEM, primarily because of the dependent nature of the metering installations. This causes errors and delays in billing customers far beyond normal levels for NEM customers. It can be expected that this would also be the case for subtractive MTR customers (further amplifying the operational costs discussed in Section 2 above).

Further, the risk of inadvertent disconnection of downstream supply in a subtractive metering arrangement does not appear to have been addressed. If it was decided that a framework to support MTR should be implemented, we recommend that subtractive arrangements should be explicitly prohibited.

3.2 Network tariff allocation

While AEMO describes the allocation of network charges to be "*critical to the efficiency of the design as well as participants' implementation costs and the costs to end users*", this issue is left unresolved in the rule change request. It is important that, if MTR arrangements are implemented a separate network tariff can be allocated to each NMI.

To contain the implementation and operational costs of establishing an MTR framework, arrangements should seek to match current NEM processes to the greatest extent possible. This requires the NMI to remain the reference point for all transactions relating to a customer. In relation to network charges, it is important that network tariffs are assigned to each NMI separately, and that there are no dependencies between them. This means that if a customer has a demand-based network charge, demand limits should be allocated to each NMI, and not the total demand across NMIs. Creating settlement dependencies

[6] AEMC, p.33.

across NMIs would be a significant deviation from how the market currently works, and would be highly costly to implement and operate.

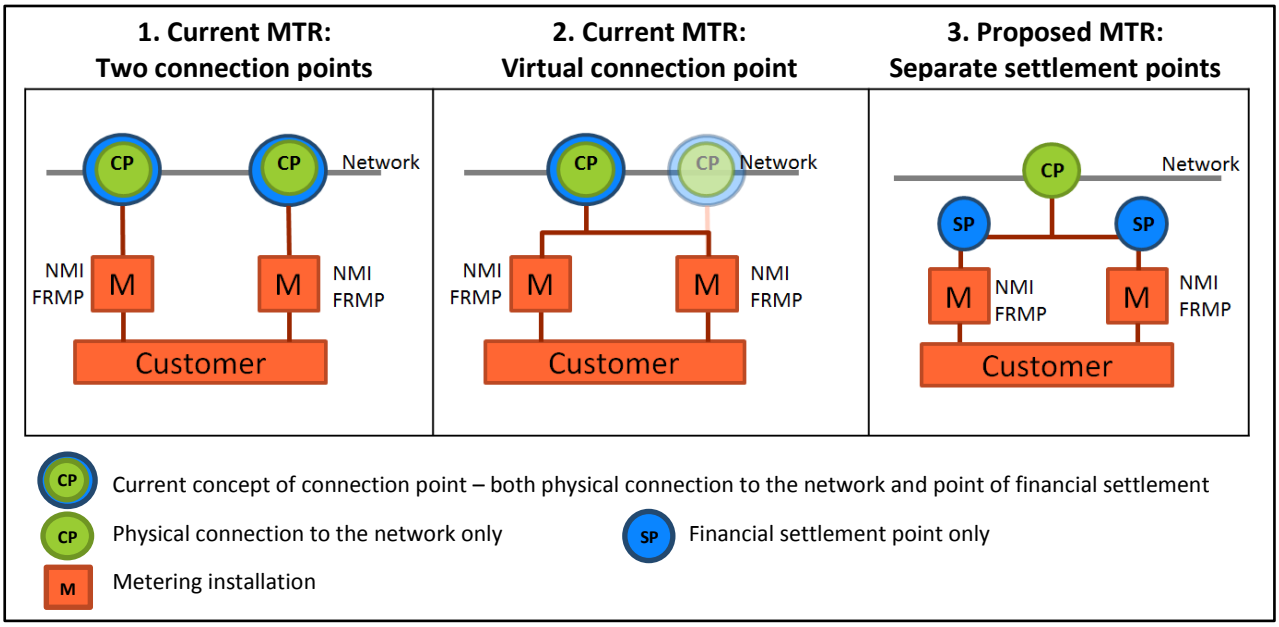
It is also important that charges are allocated in a way that maintains competitive neutrality between all retailers servicing the site. During the development of the high level design, a number of stakeholders suggested that service to property charges should be allocated to one "primary" NMI. This would mean that one retailer would be required to bear all the risk associated with cost recovery for this significant proportion of the customer's charges. Further, it was suggested that the existing retailer at the premises when MTR is established (i.e. the retailer that has just lost a proportion of its contracted load) should be responsible for the charge. This provides a competitive advantage to the second retailer at the site. Such arrangements are strongly opposed by ERM Power, and we are pleased that AEMO acknowledges that this would unnecessarily increase costs. However, AEMO has not put forward a clear alternative proposal.

ERM Power believes that, should MTR be implemented, the only way to equitably allocate network charges would be to require network businesses to develop a range of network tariffs to apply to various MTR arrangements. These would reflect the efficient costs of servicing those loads (for example, separate tariffs for general light and power NMIs, generation-only NMIs, controlled-load appliance NMIs and electric vehicle NMIs). We recognise the development, implementation and ongoing management of a new range of tariffs would come at significant cost to industry, and therefore the benefits of implementing MTR would need to be demonstrated to be more significant to justify doing so.

4. MTR arrangements can be delivered today sufficiently to manage the rare cases where it is required

While it is by no means common, many retailers do have experience servicing sites that have similar characteristics to an MTR arrangement. Figure 1 below illustrates the difference between these arrangements and what is proposed by AEMO.

Figure 1: Comparison of current and proposed MTR arrangements



1. Current MTR: Two connection points

The first diagram in Figure 1 illustrates the metering configuration which is generally considered the alternative approach to the MTR proposal: where there is a separate connection point for each NMI. This

may be used for large commercial sites, and for residential sites with multiple dwellings at one physical address. The separate connection points allow each NMI to be treated as two separate customers from a systems perspective (though because these are generally serviced by one retailer, the retailer may offer consolidated billing to simplify the customer experience). Under this arrangement, network businesses would generally allocate separate daily access charges and usage rates to each NMI, however for the largest sites alternative arrangements have been negotiated between the customer and the network.

2. Current MTR: Virtual connection point

The second diagram operates similarly to the first, however there is only one physical connection to the network, with the meters wired in parallel. This may be referred to as a "virtual" connection point, because retailer systems operate as if there is a second connection point, but this connection point does not physically exist. This configuration is possible because the NMI, and not the connection point, is treated as the unit of transfer in retailer systems. Retailer systems associate all customer information and standing data with a NMI, and the only task that would require an action associated with the connection point would be a pole-top disconnection. Therefore, provided the meters are arranged in parallel and not series, a retailer would be largely indifferent to the wiring arrangements between the meter and the connection point. Under this configuration, the customer would generally be assigned one access charge (for the one connection point) and usage rates at each NMI, however this approach is not consistent. Networks in New South Wales tend to multiply the access charge by the number of NMIs at the premises.

This configuration is very rare today, so the low incidence allows it to be managed in a bespoke manner.

3. Proposed MTR: Separate settlement points

The third diagram is AEMO's proposed parallel MTR configuration. The rule change request separates the physical connection point from the financial settlements point. We expect that from a retailer's perspective this would be the same operationally as the virtual connection point arrangement illustrated in the second diagram. We understand the objective of this separation to be purely to clarify the legal and regulatory framework for MTR arrangements. While we acknowledge that the current regulatory arrangements do not provide specific obligations where there are multiple retailers servicing one customer, they provide sufficient guidance to enable retailers to extrapolate an appropriate approach. Risks of customer harm are further mitigated by the fact that the customers who currently seek these arrangements are either large customers, or highly engaged smaller customers, who are not dependent on the customer protection regime to the same extent as more vulnerable customers.

Comparing existing and proposed arrangements

While MTR can be facilitated by existing arrangements, it does so by a combination of bespoke arrangements and regulatory extrapolation. These arrangements would not be able to efficiently support MTR-arrangements if they were broadly adopted by the mass market. However, we believe that implementing the proposed rule change would not materially reduce this burden. As discussed in Section 2 above, there will be additional costs to serve MTR customers, much of which results from the increases in the number of errors, enquiries and complaints associated with each customer. This is a characteristic of MTR that we believe cannot be avoided.

The weak value proposition for establishing MTR-arrangements would mean that customer take-up is likely to remain very low. On this basis, we consider there to be little risk in continuing to support these cases through bespoke operational arrangements under the existing regulatory framework.

Establishing AEMO's proposed legal framework to enable MTR would be likely to require amendment of all national and state regulatory instruments – a costly and challenging undertaking that we do not

believe is justified. We are concerned that if this was undertaken, then there may be political will to encourage uptake of MTR arrangements in an attempt to create this justification. Aside from the risk that customers and businesses may be encouraged to participate in something that may not be in their best interests, increased uptake of MTR would then significantly increase the operational costs borne by industry, and ultimately recovered from customers.

We therefore conclude that the current regulatory arrangements can sufficiently support the rare instances where an MTR arrangement is required by a customer.