



1 February 2015

Ms Nicole Wong
Economic and Financial Group
Chief Minister, Treasury and Economic Development Directorate
GPO Box 158
Canberra City ACT 2601

By email: energyindustrylevy@act.gov.au

Dear Ms Wong

RE: Investigation of the ACT Energy Industry Levy Discussion Paper

ERM Business Energy welcomes the opportunity to respond to the Chief Minister, Treasury and Economic Development Directorate's (CMTEDD) Discussion Paper on the investigation of the ACT Energy Industry Levy (EIL).

About ERM Business Energy

ERM Power Retail Pty Ltd, which trades as ERM Business Energy, is a subsidiary of ERM Power Limited, an Australian energy company that operates generation and electricity sales businesses. Since launching in 2007, ERM Business Energy has grown to become the fourth largest electricity retailer by load in Australia, with operations in every state and the Australian Capital Territory. ERM Business Energy is now the second largest electricity retailer to the large business market by load,¹ with increasing success in the small business market.

Review of the Energy Industry Levy methodology

With the EIL established in 2000, we agree that it is timely to review its methodology. Since that time, the regulatory framework and the participants servicing the ACT have changed significantly. In this context, it is important to consider whether the current EIL methodology continues to be fit for purpose.

We have considered the EIL methodology based on the following principles:

- The EIL should be administratively simple.
- The EIL should be structured to enable participants to appropriately forecast their costs.
- The EIL allocated to participants should be reflective of the degree to which they contribute to regulatory costs.
- The EIL should ensure accurate cost-recovery of regulatory costs.

These principles were developed based on the issues highlighted by the CMTEDD in the Discussion Paper, as well as what we consider to be good practise cost-recovery. We recognise that an assessment will require a trade-off of these principles, based on relative importance.

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

Assessing the current EIL methodology

ERM Business Energy has determined that the current EIL methodology does not appropriately meet these principles. The CMTEDD raises concerns with the annual volatility of the EIL, which may make cost forecasting problematic for participants. In addition to it contributing to forecasting challenges, we also consider the current fixed-plus-variable structure to be unnecessarily complex.

Additionally, the current EIL methodology fails to be reflective of the degree to which participants contribute towards regulatory costs. While we recognise that the two-part structure reflects the fixed and variable nature of various regulatory costs, it is unclear why the variable component is allocated based on the volume of energy provided to the ACT market. We consider that variable regulatory costs are more likely to align with the number of customers serviced. Put another way, the level of resources required to monitor and enforce a participant's compliance is more likely to increase with the number of customers serviced, rather than the volume of energy consumed by each customer. Further, the regulatory regime for small energy consumers is more comprehensive, and therefore more resource-intensive to manage, than that applicable to large energy consumers. It is therefore inappropriate that larger volumes of energy should correlate with a higher EIL.

The annual adjustment process enables cost-recovery that is accurate, based on revised information. We support this mechanism.

Our preferred option

The CMTEDD has put forward four options as follows:

- Option 1: Fixed Methodology.
- Option 2: Variable Methodology.
- Option 3: Variable Methodology (with minimum fee).
- Option 4: Current Methodology (with defined fixed fee).

While both Options 1 and 4 would improve participant's ability to forecast their EIL in advance, both fail to allocate costs that are reflective of the degree to which a participant contributes to regulatory costs. We consider this an inappropriate trade-off, as it is likely to place an unfair burden on small participants relative to larger incumbents. The CMTEDD acknowledges that the current methodology has this effect.² This could act as a barrier to entry, and have adverse consequences for retail competition in the ACT. ERM Business Energy therefore does not support these options.

In contrast, Options 2 and 3 have the potential to achieve equitable cost-reflectivity, where the methodology is amended to allocate costs based on the number of customers serviced rather than the volume of energy provided. The variable methodology would be more difficult to accurately forecast compared to the fixed methodology, though we consider it would improve predictability compared to the current methodology. This is because forecasting the number of customers expected to be serviced in a given year is critical to many aspects of operating a retail or distribution business, and so sophisticated systems and processes are already in place to support this. The fixed component under the current methodology represents an additional unknown factor. Should Option 2 or 3 be adopted, the

² Chief Minister, Treasury and Economic Development Directorate, *Investigation of the ACT Energy Industry Levy Discussion Paper*, December 2015, p. 13

only input that remains problematic to forecast is the rate at which costs are assigned to each customer in a given year.

We believe this can be simply overcome. The Levy Administrator is currently required to determine participant EILs by 1 October each year, to apply in the same financial year. We suggest that this requirement could be altered to require determination of the variable rate (to be allocated on a per-customer basis) to be determined by March each year, to apply to the following financial year. By notifying the rate, and not the total EIL for each participant, the Levy Administrator is only required to ascertain the total number of customers in the market, rather than each participant's market share. Participants are better placed to forecast their market share, and therefore it is appropriate that they take on this risk.

While we recognise that regulatory costs may not be firm by this stage in the year, we consider that the existing annual adjustment mechanism provides the opportunity for this to be corrected as required. This early notification would allow sufficient time for participants to account for their expected EIL in cost-recovery decisions before the start of the financial year.

Our preferred Option is Option 2, as this is the simplest approach of both variable methodology options. We reiterate that this methodology should be amended to allocate costs based on the number of customers serviced, rather than the volume of energy provided. We recommend that the CMTEDD give this due consideration.

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

Yours sincerely,

[signed]

Jenna Polson
Manager, Regulatory Affairs