



8 August 2019

Ms Anne Pearson  
Chief Executive  
Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Dear Anne

**AEMC reference EMO0037 – draft report on stand-alone power systems - priority 2**

Thank you for the opportunity to comment on the Commission's draft report 'Review of the regulatory frameworks for stand-alone power systems - priority 2'.

The Energy & Water Ombudsman NSW (EWON) investigates and resolves complaints from customers of electricity and gas providers in NSW, and some water providers. Our comments are informed by these complaints and from our community outreach and stakeholder engagement activities.

## Summary

- We recommend that the proposed framework be designed now to anticipate the inevitable growth in third party stand-alone power systems (SAPS), and address the fundamental problems such growth has caused the current retail exemption framework. To address these issues operators of category 2 SAPS should be required to obtain a national retail authorisation.
- We highlight the lessons we have learnt from the rapid growth in the embedded network industry, that indicate:
  - Most consumers do not choose to live in embedded networks – instead, developers, specialist billing agents and retailers have driven growth in the number of embedded networks.
  - Tiered consumer protections, such as those provided by the AEMC's proposed framework for third party SAPS, lead to unequal consumer outcomes.
- We believe that the National Energy Retail Law (NERL) must be updated to capture the retail services provided by specialist billing agents. This business model will quickly extend to third party SAPS and should be regulated appropriately for both embedded networks and SAPS.
- We provide two alternative models for the regulation of third party SAPS:
  - A model that includes the requirement for all category 2 SAPS operators to obtain a national retail authorisation

- A model that includes the requirement for an entity providing retail services to more than one category 2 SAPS (residential) to obtain a national retail authorisation.

## The SAPS framework must address the fundamental problems faced by the current exemption framework

The retail and network exemption framework established under the NERL and the National Energy Retail Rules (NERR) was never intended to provide a regulatory system covering large numbers of small retail customers. Instead, the framework was developed by the AER based on the principle that some of the requirements set out in the NERL and NERR were not relevant for exempt entities:

*‘Retailers achieve economies of scale by having a large customer base, which allows them to spread the cost of regulation over the large number of customers. Exempt persons tend to serve a smaller number of customers and therefore will not usually achieve comparable economies of scale. This makes certain requirements under the Retail Law and Retail Rules more burdensome and less appropriate for exempt persons.’<sup>1</sup>*

As early as 2011, the AER also recognised that there had been particular growth in on-selling within high density residential developments such as apartment buildings. At this time, the AER stated that it did not want on-selling to be a motivating factor for developers in deciding how these developments are structured<sup>2</sup>.

In 2019, eight years later, the AEMC’s review of the regulatory framework for embedded networks concluded the framework was becoming increasingly complex, giving rise to regulatory gaps, and was no longer fit for purpose given the growth of embedded networks as a business model in itself<sup>3</sup>. The AEMC’s review concluded that consumer protections should be fundamentally driven by the needs of consumers, rather than the business model of the supplier<sup>4</sup>.

The rapid growth in the number of embedded networks since 2011 has clearly been driven by developers, energy retailers and billing agents, rather than consumer choice. Considering this, we believe that the regulatory framework for stand-alone power systems (SAPS) must be designed to anticipate a future rapid growth in third party SAPS. The future growth in the number of SAPS will also not be driven by consumer choice – it will be driven by the ongoing demand for affordable housing, and the opportunities presented to developers and energy retailers through the increasing efficiencies and decreasing costs of new energy technologies.

Therefore, we ask the AEMC reconsider the draft framework, specifically the regulation of category 2 SAPS, to account for the inevitable growth in the proportion of small retail customers living in SAPS.

We recommend that category 2 SAPS retailers should be required to obtain a national retail authorisation from the AER. This will ensure consumer protections continue to be driven by the needs of consumers, rather than the business model of the supplier, and ensure the framework

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<sup>1</sup> AER, Exempt selling guideline, Version 1, December 2011, p7

<sup>2</sup> Ibid, p3

<sup>3</sup> AEMC, Updating the regulatory frameworks for embedded networks, Final report, 20 June 2019, p28

<sup>4</sup> Ibid.

remains fit for purpose following rapid growth in the number of SAPS developments. See figures 1 and 2 below for our suggested alternative regulatory models for third party SAPS.

## The lessons we learnt from the operation of the network and retail exemption frameworks

1. Most consumers do not choose to live in embedded networks – instead, developers, billing agents and retailers drive growth in the number of embedded networks

The regulatory framework for stand-alone power systems (SAPS) proposed in the draft report is underpinned by the idea that customers will have a higher degree of choice to enter into a supply arrangement where electricity is supplied by a third-party SAPS, than for supply by a DNSP-led SAPS, and for supply by an embedded network<sup>5</sup>.

In its submission to the consultation paper, the AER argued that the creation of, or transition to, a third party SAPS will be motivated primarily by consumer's choosing a mode of electricity supply that helps them achieve objectives that are not well met by on-grid arrangements<sup>6</sup>. However, the AER also noted that not all customers will be able to exercise this choice, such as renters and customers on low incomes who have little practical choice between different models of supply and will continue to rely on the traditional grid to provide essential electricity services<sup>7</sup>.

We believe that the position taken by the AEMC and the AER does not account for the lessons learnt from the operation of the current retail and network exemption framework. We agree that there are some embedded networks that have been established with the intention to deliver improved customer and environmental outcomes. However, the rapid growth in embedded networks since 2011 has been fuelled by a construction industry responding to the increasing demand for affordable housing options – not by consumer choice. The commercial arrangements between utility providers (retailers and third-party agents) and developers are initiated well before a residential building is completed. These agreements provide the developer with a way to offset the cost of connecting utilities to the new development, and enable the utility provider to lock in long term service contracts before residents move in and take over management of the strata corporation.

We consider that with advancing technology and decreasing costs, there will also be an inevitable rapid growth in the number of SAPS over the next 10 to 20 years. This will include brownfield conversions of existing embedded networks into SAPS once technology allows for this scale of project.

Over the years we have received many complaints from embedded network customers who don't even know what an embedded network is before moving into one. We have also seen ongoing consumer complaints about the benefits of living in an embedded network being eroded over time. We have received recent complaints where representatives for residential complexes were seeking

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<sup>5</sup> AEMC, Review of stand-alone power systems - priority 2, Draft report, 27 June 2019, p30

<sup>6</sup> AER, Submission to the consultation paper, Review of the regulatory frameworks for stand-alone power systems - Priority 2, 29 March 2019, p3

<sup>7</sup> Ibid.

advice about transitioning out of being an embedded network, because the commercial contracts with the utility provider disadvantaged the strata corporation, and individual households would be better off with access to the retail market. Any substantial growth in the number of third party SAPS will likely come with very similar consumer issues.

We strongly recommend that the AEMC does not determine the level of regulation for third party SAPS based on a perception that customers will be making a choice to live in a SAPS and consciously trading away certain consumer protections. The AEMC must anticipate a future rapid growth of SAPS driven not by consumer choice, but by innovations in the energy, housing and construction industries.

## 2. Tiered consumer protections lead to unequal consumer outcomes

Through our ongoing contact with consumers living in embedded networks, EWON has long held the view that a regulatory framework containing tiered consumer protections leads to unequal consumer outcomes. A central issue for embedded network customers is that their energy specific consumer protections are contained in a number of conditions set out in the AER (Retail) Exempt Selling Guideline, and not the NERL and the NERR which apply to all other standard grid connected customers.

The core conditions set out in the exempt selling guideline are intended to provide a similar level of consumer protections for embedded network customers to those established through the NERL and the NERR. However, as we highlighted in our 2016 public report on embedded networks, and in our subsequent submissions to the AEMC and the AER, having two sets of rules for different groups of consumers has led to confusion and frustration for many embedded network customers, and poorer outcomes for some customers relating to pricing, customer service and hardship support<sup>8</sup>. The consumer frustration and unequal consumer outcomes hinges critically on a lack of consistency between the conditions contained in the guideline compared to protections contained in the Law and the Rules, and a lack of bargaining power for individual customers to negotiate the outcomes they need.

We agree with the AEMC that the proposed framework for third party SAPS must be flexible. However, the exemption framework was also initially established because the regulatory obligations placed on authorised retailers were considered excessive or inappropriate for small embedded network on-sellers<sup>9</sup>. However, in its 2017 review, the AEMC found that the exemption framework is no longer fit for purpose due to the growth in number and scope of embedded networks. The AEMC also found that regulatory gaps existed due to the increasing role of authorised retailers in the embedded network retail space<sup>10</sup>.

If the AEMC proposes a framework with tiered consumer protections for large numbers of small energy consumers, this framework will also have a high risk of becoming unfit for purpose with the inevitable growth in third party SAPS. A tiered framework will be difficult and costly to redesign if it fails to deliver the required consumer outcomes.

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<sup>8</sup> EWON, Rising Inequality in the Energy Market: Safeguarding Consumer Protections, Report, September 2016, p14-23

<sup>9</sup> AEMC, Review of regulatory arrangements for embedded networks, Final Report, 28 November 2017, p20

<sup>10</sup> Ibid, pi

We recommend that the proposed framework be changed to require all category 2 SAPS to obtain a national retail authorisation and provide the AER with the power to exempt SAPS retailers from sections of the NERL and NERR that are not relevant for the specific group of consumers. See figures 1 and 2 below for our suggested alternative regulatory models for third party SAPS.

## The definition of ‘selling energy’ in the National Energy Retail Law should be widened to include billing agents

The role played by specialist embedded network billing agents, and the growth of this business model, has acted as an important catalyst for the weakening of the current retail exemption framework. The AEMC final report on updating the regulatory framework for embedded networks recognised this issue:

*‘in recent years new types of businesses have emerged that fund and supply the metering and other electrical infrastructure in apartment complexes. In return, these businesses may receive lengthy contracts to provide power to the whole building and effectively become a monopoly retailer to occupants. Many such businesses also provide other bundled services, including hot water, chilled water for air conditioning, gas for cooking and telecommunications’<sup>11</sup>.*

Central to the billing agent business model is the commercial contracts agreed to between the developer and the billing agent. Customer complaints to EWON and our engagement with embedded networks as potential members indicate these contracts are largely beneficial to the billing agent providing them with complete control over the retail services offered to residents, including pricing, and the ability to pass on the regulatory responsibility and costs to the strata corporation, who is registered as the exempt seller. The billing agent avoids the regulatory burden because the energy is purchased at the parent connection point in the name of the strata corporation. The AER has made it clear that billing agents are not selling energy under the NERL because they are not purchasing the energy at the parent connection point.

Our ongoing engagement with strata corporations registered as exempt sellers show that residents not only have no control over the retail services provided within the embedded network, but they are also responsible for most of the regulatory cost and burden:

**Table 1:** A typical relationship between exempt retailers and their billing agent

Function / role	Exempt retailer (registered)	Embedded network billing agent
Determines energy pricing	✗	✓
Scheduling charges and fees	✗	✓
Billing	✗	✓
Opening and closing accounts	✗	✓
Determining customer contract terms and conditions	✗	✓
Payment methods	✗	✓
Customer service and complaint handling	✗	✓

<sup>11</sup> AEMC, Updating the regulatory frameworks for embedded networks, Final report, 20 June 2019, pii

Function / role	Exempt retailer (registered)	Embedded network billing agent
Debt collection and customer hardship	x	✓
Disconnections and reconnections (including for non-payment)	x	✓
Purchases energy at parent connection point *	✓	x
Legal responsibility for compliance	✓	x

\* the billing agent is often responsible for negotiating the purchase of energy at the parent connection point, and managing the contract, but does so in the name of the exempt retailer.

This issue will also affect future energy consumers living in third party SAPS unless amendments are made to the NERL to expand the definition of ‘selling energy’ to include the entity that provides the majority of retail services to the consumer.

The definition of ‘selling energy’ under the National Energy Retail Law (NERL) must be updated to include the entity that provides the majority of retail services to a small residential customer.

## Two alternative models for the regulation of third party SAPS

### Alternative model 1: all category 2 SAPS operators required to obtain a national retail authorisation

We note that the current proposal for a tiered approach is based on a model put forward by IPART to a NSW government consultation. This model was initially concerned with the safety regulation for both interconnected and stand-alone systems, however, the idea has been expanded by stakeholders into a complete regulatory framework for third-party SAPS<sup>12</sup>. As discussed earlier, we believe that a tiered approach is fundamentally vulnerable to the same problems that rendered the current exemption framework unfit for purpose.

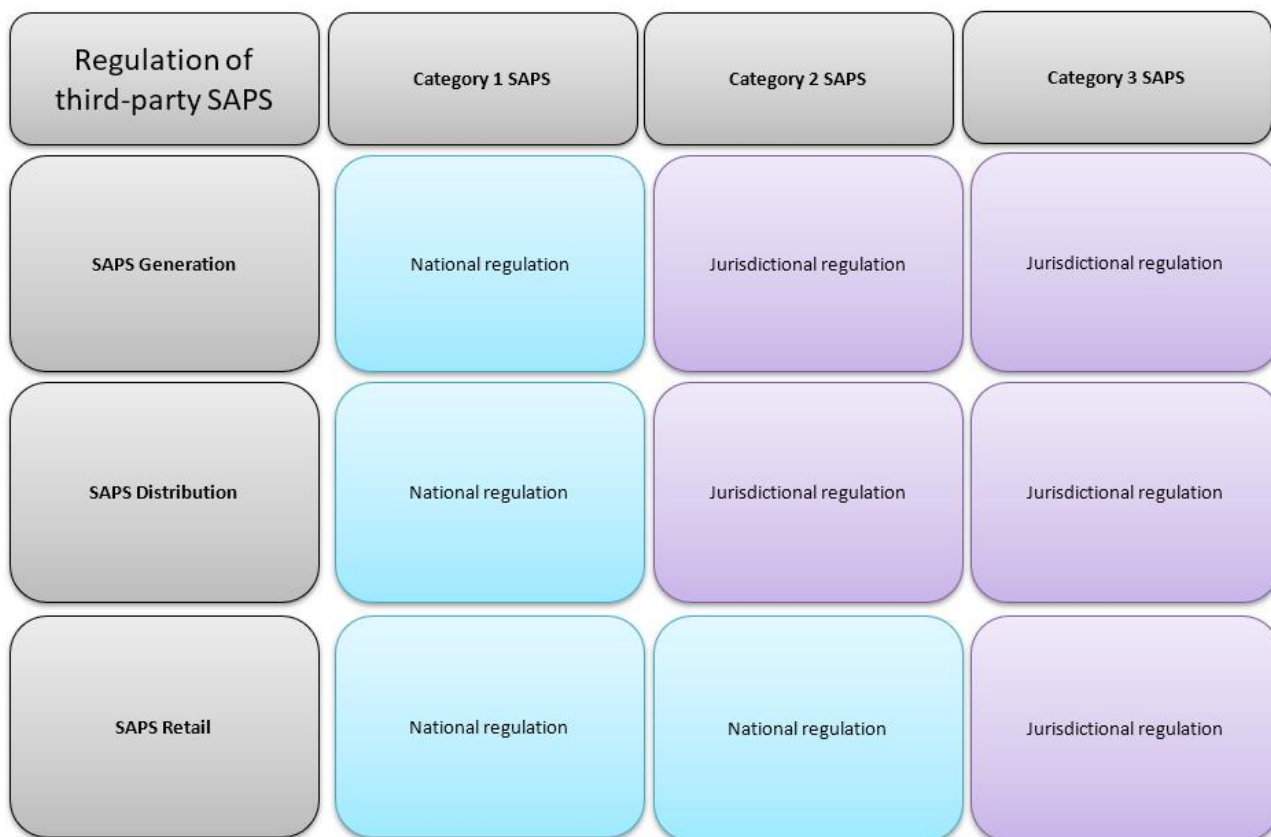
We agree with the AEMC’s assessment that some consumer protections under the NERL and NERR may not be relevant as there may be no marketing and transfer activities, market settlement, and fewer relevant rules concerning shared customers and the tripartite relationship<sup>13</sup>. However, we believe that a more appropriate model would require all retailers of category 2 SAPS to obtain a national retail authorisation. The framework could be made more flexible by providing the AER with the power to exempt a SAPS retailer from specific rules that are not relevant to its customers.

This will ensure consumer protections continue to be driven by the needs of consumers, rather than the business model of the supplier, and ensure the framework remains fit for purpose following rapid growth in the number of SAPS developments.

<sup>12</sup> AEMC, Review of stand-alone power systems - priority 2, Draft report, 27 June 2019, p33

<sup>13</sup> Ibid, p92

**Figure 1:** A regulatory model that includes the requirement for all category 2 SAPS operators to obtain a national retail authorisation.



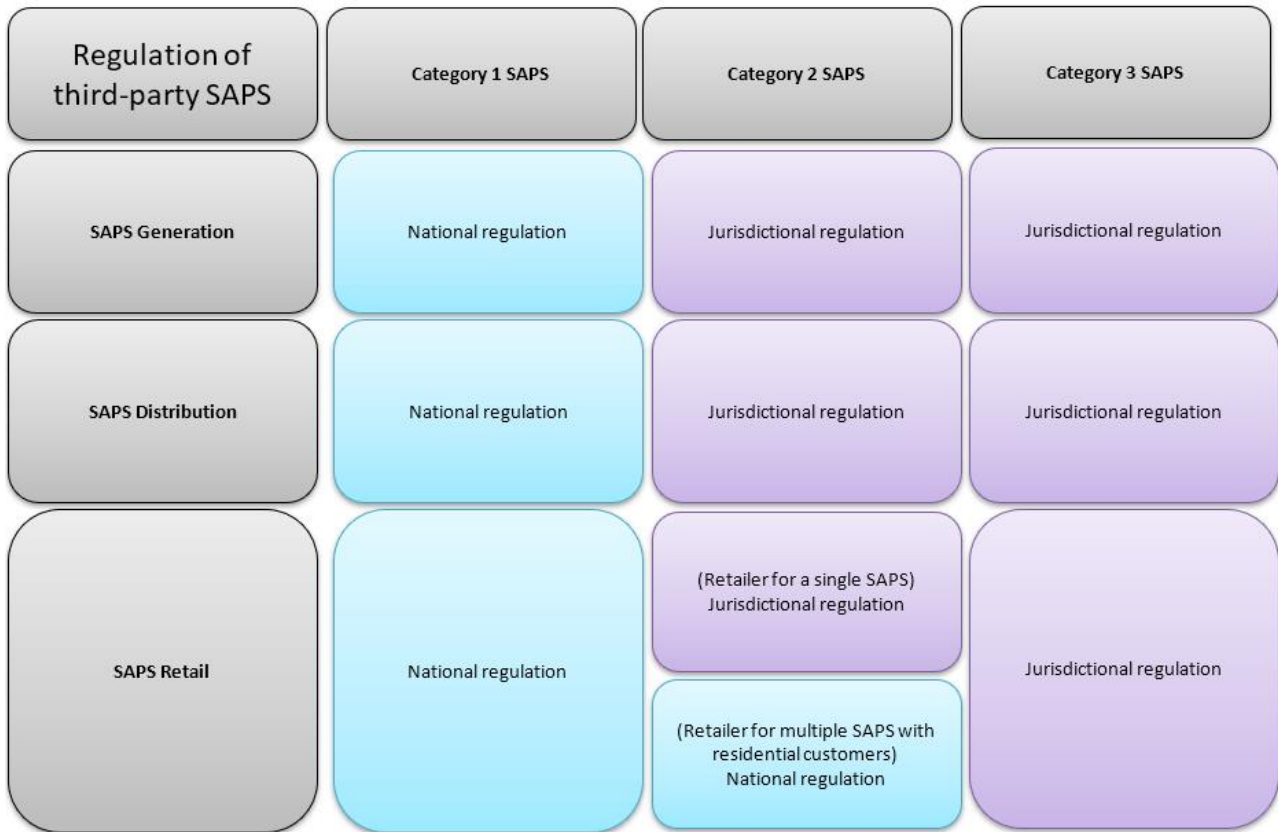
**Alternative model 2:** a trigger requiring retailers for multiple SAPS to obtain a national retail authorisation

In this submission, we have highlighted that one of the central problems with the current retail network exemption framework has been the rapid growth in the embedded network business model. Authorised retailers, and specialist embedded network providers, are now frequently controlling the retail services for multiple embedded networks. This growth has also resulted in a situation where some specialist embedded network providers (including unregulated billing agents) service as many customers across multiple embedded networks as some second tier retailers do in the National Energy Market.

The AEMC draft report asks whether there would be merit in allowing a category 2 retailer to elect to become a category 1 retailer, authorised by the AER and regulated under the NECF framework. This would require the third-party SAPS provider to disaggregate its retail function.

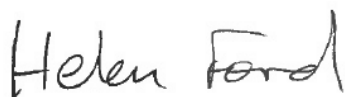
We believe that the proposed regulatory framework should instead require a category 2 SAPS provider, that provides retail services to more than one SAPS with residential customers, to obtain a national retail authorisation. This would avoid future specialist SAPS providers acquiring large numbers of customers while avoiding the regulatory burden of an authorised retailer. In the below model, we illustrate how the proposed framework could include a trigger requiring operators of multiple SAPS to obtain a retail authorisation.

**Figure 2:** A regulatory model that includes the requirement for an entity providing retail services to more than one category 2 SAPS (residential) to obtain a national retail authorisation.



If you would like to discuss this matter further, please contact me or Rory Campbell, Manager Policy and Research, on (02) 8218 5266.

Yours sincerely



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