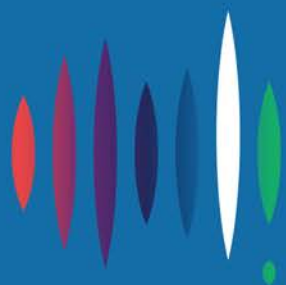


Embedded Networks

Submission to AEMC Review

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**ENERGY
CONSUMERS
AUSTRALIA**

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Introduction

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the Council of Australian Governments (COAG) in January 2015, our objective is to promote the long-term interests of energy consumers with respect to price, quality, reliability, safety and security of supply.

We appreciate the opportunity to respond to the Australian Energy Markets Commission (AEMC) review of the retail rules relating to embedded networks and exempt seller arrangements (the Review). The AEMC is approaching the issues through four core questions for stakeholders:

1. Is the regulatory framework fit for purpose?
2. Can access to retail market offers be improved?
3. What consumer protections should apply to embedded network customers?
4. Are current regulatory arrangements for gas embedded networks appropriate?

The Review is being conducted at the same time as the COAG Energy Council's Energy Market Transformation Project Team (EMTPT) is concluding its consideration of consumer protections and regulatory frameworks for Behind the Meter and Stand Alone Power Systems. Many of the issues in those are considerations about embedded networks. It is important therefore that a consistent approach is adopted across these workstreams.

We start this submission with some observations about the consumer protection framework for energy consumers in general, and how the market and technology is evolving. We highlight the importance of consumer protections in consumer trust and confidence in participating in the market.

We then respond to the four core questions the under the headings:

- Regulatory framework
- Access to retail offers
- What protections should apply
- Arrangements for gas

A core principle for Energy Consumers Australia is that consumers in embedded networks should have no lower level of consumer protection than consumers who purchase their energy directly through the retail market (standard supply services). Embedded networks and other 'alternative' energy supply configurations attract different (usually lower) obligations under the National Energy Retail Law (NERL). As the number of these alternative arrangements grows there is an increased risk of detriment that could undermine confidence in the market.

We have chosen to advance 'propositions' to inform thinking about how we adapt the regulatory and consumer framework rather than make recommendations. This reflects the various pieces of work that are underway in this space and the need to consider the consumer protection framework holistically.

We note that the legislative language of 'exempt seller' is problematic. Contrary to a plain English interpretation of the term; exempt sellers are only exempt from gaining an authorisation, they still have (enforceable) conditions on their supply of energy.

Access to retail markets (on market offers) is unlikely to be an effective constraint on the market power of exempt sellers. There are few retailers, if any, actively seeking the custom of embedded customers. In these cases the sole price protection is the standing offer of the designated local retailer,

Retail prices are showing increased dispersion between standing offer prices and market offers, creating artificially high standing offer prices to provide ever larger headline discounts. The artificially high standing offer is acting as an incentive for inefficient brownfields conversion to embedded networks.

Where the embedded network includes distributed energy resources (DER) access to retail markets is likely to be an even more ineffective option. The consumer who takes the 'on market' offer will be denied the benefits of the lower price of energy produced (and possibly stored) by the embedded network assets. In these cases the retail price is likely to be higher than the embedded network price, even if the embedded network operator is charging more than a price that reflects the cost of grid and DER provided electricity.

Consumer Protection in Energy Markets

The purpose of consumer protection

Effective competition benefits consumers by reducing prices and promoting innovation. The Australian Consumer Law (ACL) provides a substantial suite of consumer protections across all markets. A core objective of the ACL is to give consumers confidence to participate in the market, not to protect them from the market.

Notwithstanding these general provisions there are still cases, such as energy, where additional protections are provided. Energy Consumers Australia has identified four reasons why these additional protections exist:

1. the essential service or non-discretionary nature of the purchase;
2. the provision of credit as a standard feature of supply;
3. the use of standard form contracts; and
4. the behavioural bias of consumers used to the supply of the service from a Government agency rather than a commercial firm (put simply consumers may be too trusting.)

The provision of an Ombudsman scheme for complaints can in part be traced to the coverage of energy matters by state government schemes when the service was provided by a government agency. It can otherwise be considered as a specific instance of protections of the fourth type.

Together with the general protections, these result in four groups of protections that apply:

1. consumer protections that address the consumer/provider interface;
2. consumer protection for affordability (including concession schemes and aspects of hardship policies);
3. the regulation of the electricity system to guarantee availability of supply (which includes quality and reliability and an element of rules regarding disconnection for non-payment); and
4. the regulation of firms with market power.

In general, the fourth group of protection is delivered through the structural separation of natural monopoly networks from competitive (retail) markets. It is, however, a relevant consideration in embedded networks.

Use cases

The technical definition of an embedded network is, as laid out in the consultation paper, relatively straight-forward. However, what lies behind the ‘parent connection point’ has significant implications for the options available to consumers.

In our submissions to the EMTPT discussions on Behind the Meter and Stand Alone Power Systems we introduced a ‘typology’ of configurations. Recognising the number of different uses of various terms Energy Consumers Australia is now referring to these as ‘use cases.’

The variety of scenarios under which consumers can be acquiring their energy services (primarily their electricity) can be broken down into six primary use cases based on two dimensions.

Table 1: Electricity supply use cases

	Grid ONLY	GRID + DER	DER ONLY
Freestanding cases	A (Standard supply)	B (Standard supply)	C (Individual Power System)
Community cases	D (Embedded network)	E (Embedded network)	F (Microgrid)

The first dimension is whether the supply arrangement for the household or business is made by themselves or has at least some element of decision making for the whole community. In the description below this is referred to as ‘freestanding’ or ‘community’.

The second dimension is based on what the source of supply of the electricity service is. The first case is where all energy is supplied by a connection to a grid, the second case is a grid connection that is augmented by distributed energy resources. The final case is where there is no grid connection.

These six alternatives we refer to as use cases A to F. The descriptions in brackets below the letters refer to the key definitions used in the AEMC Consultation Paper.

The relationship to the EMTPT consultations is reflected in Behind the Meter covering both use cases B and E. Additional issues are created with the concept of 'grid disconnection' as services move from case B to C or from E to F. The latter is covered by a rule change proposed by Western Power that is being considered by the AEMC

The exempt seller arrangements

The consumer protection issues that are arising in embedded networks do not derive directly from the features of this kind of energy supply arrangement itself but from the related concept of an 'exempt seller.'

The concept of an exempt seller is a carry-over from the application of the term in the original National Electricity Code where it referred to energy sellers who did not have to be part of the wholesale market. The term has been carried forward into the retail law to refer to a person or entity exempt from the requirement to hold a retailer authorisation.

Technically there are three separate instruments that are made by the Australian Energy Regulator (AER) to establish the exempt seller framework.

1. Under s88 of the National Electricity Law a person selling energy must either have authorisation or exemption.
2. Under Rules 150 and 151 the AER makes Determinations that establish the classes of deemed and registerable exemptions. These appear as Appendix A-1 in the Guideline documentation but technically are not part of the Guideline.
3. There are the Conditions which are imposed by Rule 152 generally but to classes by Rule 153. These appear as Appendices A-2 and A-3 in the Guideline documentation but technically are not part of the Guideline. Under s112 of the National Electricity Retail Law (NERL) an exempt seller must comply with the conditions (made in accordance with the Rules and guidelines) and the AER may deal with the breach as if it were a breach of the Rules.
4. The AER is required to make exempt selling guidelines under s118 of the Act and the Rules may make provisions relating to them. Rule 154 concerns the Guidelines. A core function of the Guideline is to outline the process and evaluation criteria for making 'individual' exemptions.
5. The AER can issue infringement notices for civil penalty provisions under s380 of the NERL, which in turn invokes the procedure of Part 7 of the NGL. Penalty less than \$20K for body corporate, \$4K for an individual.

Confusingly the AER calls the document that summarises the legal obligations that govern exempt sellers 'The Guideline' whereas the guideline is only one of three distinct components of the framework. Since guidelines do not usually bind anyone other than the regulator, this can give the impression that compliance with the regime is voluntary, undermining its effectiveness.

There are three types of 'exempt sellers' under the framework, 'deemed', 'registrable', and 'individual'. A simple numerical rule – the number of meter points within the embedded network – determines which category the embedded network will fall under.

Regulatory framework

Overall construct

The exempt seller arrangements are unhelpfully named. The sellers still have conditions on their supply of services that must be met and they are enforceable.

In most cases the exempt seller is better described as a reseller (this applies to all cases of embedded networks but not to exempt sellers of Power Purchase Agreements); the exempt seller is buying energy from a retailer that is measured at the parent meter. Renaming the class of provider as 'resellers' in legislation would provide greater clarity to the function of these agents and remove the implicit idea that they are exempt from any conditions; they are still performing a regulated function.

Proposition 1: The NERL be amended to change the description of persons supplying energy other than as authorised retailers to NEM connected premises as 'resellers' rather than 'exempt sellers.'

Proposition 2: The AER republish the exempt seller documentation as a Framework and clearly delineate the three instruments of the determination, the conditions and the guideline.

Sale of PV and exempt sellers

The core trigger for coverage of the NERL is the sale of 'energy services'. This means that a solar PV provider who contracts with customers via a Power Purchase Agreement (PPA) qualifies as an 'energy supplier' and is covered as either an authorised or exempt seller. Meanwhile the seller of a solar PV unit to the consumer directly is not engaged in 'energy supply' and is not subject to the NERL. A key consequence for is that the consumer in the first scenario has access to ombudsman services, while in the second they do not, despite the common issues that can arise under both.

Distinctions of this nature are inimical to the policy goal of consumer protection – providing consumers with a consistent set of rights and remedies and ultimately the confidence to engage in the market. There are two possible ways to remedy this. The first is to redefine the concept of supply of energy services to refer to 'services supplied from the grid'. The second is to change the definition of energy services to include the sale of solar PV and other equipment that can provide energy.

The solution that should be adopted depends on the approach taken for Behind the Meter protections. Submissions to the EMTPT process called for all provision of behind the meter equipment to be covered by Ombudsman schemes. This is the protection for customers of PPA sellers most sought under the exempt seller arrangements. If Ombudsman schemes can be extended to include all DER sales, then the option of defining energy seller narrowly to sale of grid energy should be adopted.

Proposition 3: In conjunction with the Behind the Meter review a common approach to consumer protection for the provision of PV by PPA and the provision of it by outright sale should be developed.

Deeming and registering

The AER appears to apply the same conditions to exempt sellers in the comparable classes of deemed and registered sellers. Consequently, the only distinction in conditions appears to be the need to register.

There is, however, a much greater difference in the visibility of the arrangements to the regulator. While there can be questions about whether all exempt sellers required to register have done so, the deemed sellers are completely unknown to the AER.

The only argument for the AER drawing a line somewhere between deemed and registered appears to be that the AER assumed the ongoing availability of the deemed class meant someone should be covered by that class, and that registration was an 'onerous regulatory obligation.' In practice the deemed exempt seller is probably much better served by the regulatory regime by having an obligation to register.

The AER is still confronted by the issue of exempt sellers who are required to be registered not actually registering. However, as already noted the exempt sellers are really resellers and have a relationship with a retailer who can be reasonably expected to be able to identify if a connection point is a parent of an embedded network (by the amount of energy purchased).

Proposition 4: The category of deemed exempt seller be deleted and all exempt sellers be required to be registered or have an individual exemption.

Proposition 5: It should be an offence for an authorised retailer to sell energy to an unregistered exempt seller.

Individual exemptions

Individual exemptions will increasingly relate to circumstances that include DER. Under the current rules the AER must determine conditions for each applicant.

The AER is using the set of conditions developed for the other exempt sellers as a menu from which it assembles the relevant conditions for the individual exemption, and may add additional ones.

The AER should be formally empowered to create classes of individual exemption to which the applicants can be assigned, while still reserving flexibility for fully bespoke arrangements. There would appear to be nothing in the Rules prohibiting the AER from taking this approach already, however a rule permitting it will encourage the AER to use a classification system.

Proposition 6: The Rules be amended to allow the AER to create classes of individual exemptions.

Access to retail offers

The logic of embedded networks

Where there is no DER involved in an embedded network there are only a few reasons why an embedded network should be preferred to each consumer participating directly in retail markets.

The first is the nature of tenancy. Tenants who are likely to be of short duration do not need the frustration of commencing a supply agreement and then terminating; bundling supply is convenient.

The second is arbitrage; the aggregated purchasing power of all the units is sufficiently large that the additional cost of disaggregating the bill amongst units is less than the saving.

The third is some technical constraint that might limit the ability to meter the embedded network customers.

The use of DER changes this equation, because all the units are benefitting from the self-generated energy and there are significant limitations to how this could otherwise be managed.

Of these cases, the case of arbitrage is the one where the tenants are most exposed to the exercise of market power by the embedded network operator and is also the only case where direct access to retail offers is a meaningful protection.

The case of DER opens a further issue, however, where the members of the body corporate (or owners' corporation) could structure the arrangement in such a way that each unit is billed energy at a 'market-like' rate and that the profit from energy trading is distributed among the owners. This is a device by which the property owners could be utilising their market power to extract economic rent from tenants.

Access to retail offers as 'second best'

In both cases where tenants are exposed to market power requiring individual consumers to access retail offers directly is a second-best solution.

If there genuinely is an arbitrage opportunity the tenant is better off being able to gain that benefit. Similarly, the tenant is better off being able to access the building DER at a fair price than they are accessing the retail market.

Market theory would suggest that contestability, the opportunity of the tenant to access retail offers, would be sufficient to ensure that the embedded network operator provided the benefits of aggregation or of DER to their customers. However, a distinction needs to be made between a hypothetical threat and a credible threat; for contestability to be meaningful there must be retailers genuinely interested in acquiring customers.

But the retailer knows there is no value in building their business by trying to sell to the embedded network customer; not only can the embedded network

operator frustrate access, they also have the ability of rapid price response to better the retail offer.

Alternative remedies

There are two drivers for the increase in the number of embedded networks. One, to be supported, is the incorporation of DER. Large solar installation on apartment blocks can deliver better price and service outcomes for the residents as well as providing emissions reduction and energy system benefits from DER deployment.

The second is the business model of the third party embedded network operator or consultant who identifies for a network owner the opportunity of arbitrage. The embedded network owner becomes the exempt seller of record but technically outsources the functions to the consultant.

There is a real risk here that this is a business model based not on delivering real value but on identifying the opportunity to exercise and exploit market power. This risk should be mitigated by drawing the consultant into the regulatory net by applying a condition on exempt sellers that specifies the terms and conditions under which the exempt seller can outsource any of its responsibilities.

Proposition 7: The AER be required to place conditions on exempt sellers that cover the terms and conditions under which they can engage a third party to perform any or all sales functions.

The opportunity for exercise of market power in price is limited by the requirement that the price charged by the exempt seller can be no more than the standing offer of the designated retailer for the distribution area. However, the deficiencies in the retail market (competition by headline discount rather than genuine price offer) is driving increasing dispersion between standing offers and commonly available retail offers.

This deficiency could be rectified by changes in retail competition, but that is unlikely in the short term. A more immediate remedy is to change the benchmark to something based on market offers of that retailer; a possible value is the best generally available market offer or some midpoint between the best market offer and the standing offer (such as the arithmetic mean).

Proposition 8: The AEMC should consult specifically on the appropriate price cap to be applied to embedded network customers.

What protections should apply

Current protections

The conditions for registerable and deemed exempt sellers cover 21 headings, though items 20 and 21 are only applied to exempt sellers of PPAs. All 19 of the standard conditions apply to the categories of deemed and registerable exemptions covering most instances of residential and small business circumstances.

The conditions are set out more simply than the applicable conditions that apply to authorised retailers in the NERL. As part of a related piece of work Energy Consumers Australia is developing a statement of the conditions that should apply to a service provided by an authorised retailer.

The conditions cover the core elements of two of the identified categories of protections (consumer/provider interface and availability of supply). As described above they only partially deal with market power. Consumers on embedded networks are excluded from concession schemes managed by retailers.

Energy Consumers Australia is currently reviewing the consumer protections framework in the light of this review, the EMTPT reviews of Behind the Meter and Stand Alone Systems, the Productivity Commission report on ACL enforcement and the ACL review.

In principle, the consumer protection afforded to the consumer should not depend on the circumstances of supply. The provision of electricity in multi-tenanted buildings by a combination of grid electricity and DER can deliver cost and control outcomes for consumers, make a cost-effective contribution to emissions reduction and support system security and reliability. However, these desirable goals should not come at the cost of consumer protections.

As noted above the ability for a consumer to go on-market is at best a weak constraint on market power, and will be much weaker in cases where there is integrated DER. This requires some tighter constraint on pricing than that currently applied by the AER's conditions.

In terms of this inquiry the two important issues are access to dispute resolution and affordability.

Dispute resolution

The AER's Condition 15 requires the exempt seller to attempt to resolve any dispute and, if applicable, advise the consumer of their ability to access an Ombudsman scheme. This is an inadequate provision; however, it cannot be extended by the AER unilaterally because the individual jurisdictional schemes have their own rules about what disputes they cover,

To cover this limitation the condition should be substituted with a condition that the exempt seller will participate in an approved External Dispute Resolution scheme and be bound by the decision arising from that scheme.

Ideally the only schemes that would apply would be Ombudsman schemes, though if schemes cannot agree or there are other impediments the AER should create an EDR approval process. It is understood that there is an issue pertaining to the funding of Ombudsman schemes for these disputes, given that the Ombudsman are funded by authorised retailers.

However, as already noted in most cases the exempt seller is purchasing grid delivered energy from a retailer and the retailer is the body earning the market revenue for the exempt customers. There is no reason why the retailer should not be regarded as the liable party with respect to funding the disputes.

Proposition 9: Exempt sellers be required to be part of an External Dispute Resolution scheme, ideally the relevant energy Ombudsman.

Proposition 10: That condition 4 be amended to include an obligation on the reseller to include with the bill a reminder of the consumer's right to External Dispute Resolution and how to access the service.

Affordability

The AER's Condition 12 requires the exempt seller to inform the consumer of any rebates or concessions applicable, and if it is necessary that the assistance be applied for by the exempt seller, then the exempt seller will do so.

Energy Consumers Australia is not able to comment on the details of the operation of this provision across jurisdictions due to the bespoke nature of these arrangements. However, Energy Consumers Australia favours a nationally consistent approach to these arrangements, and ideally, that the income issue is addressed directly as part of incomes/welfare policy rather than energy policy.

Compliance and enforcement

Consumer protections afforded by conditions on exempt sellers are only as effective as the level of compliance. The protections must, therefore, be supported by an effective compliance and enforcement regime. Compliance is the primary goal, and enforcement is a tool whose primary intention is to increase compliance. The best enforcement programs are those that never need to be invoked.

Energy Consumers Australia notes that the primary compliance and enforcement tool for the National Energy Consumer Framework is participant self-reporting. The trigger for both self-reporting and any other action is often customer complaints, especially those escalated as disputes to the Ombudsman.

In our propositions Energy Consumers Australia is suggesting that retailers who are selling to 'resellers' should be aware that these parties are resellers. It is not an unreasonable or onerous burden to require retailers to include in bills to resellers a reminder of their need to comply with the exempt seller conditions.

Proposition 11: That authorised retailers be required to include with every bill to a reseller advice that the reseller must comply with the exempt seller conditions.

There would appear to be merit in a more active assessment by the AER of the extent of compliance, including through random audits. Energy Consumers Australia is unsure of the need for this audit especially if access to EDR can be relied on to flag compliance issues.

Arrangements for gas

Energy Consumers Australia has not formed a view on the gas market arrangements other than to note that this is an area of jurisdictional variation.

COAG Leaders instituted the process of creating a national energy consumer framework in response to the Productivity Commission, in its report on consumer protections, calling for harmonisation of industry specific consumer frameworks as well as the creation of the ACL.

The recent Productivity Commission review of ACL enforcement also made this recommendation. The AEMC in its review report should highlight that this is still a reform that is in the long-term interests of consumers that is yet to be implemented.

Accordingly, Energy Consumers Australia considers that the AEMC should recommend that the Energy Council agree to further harmonisation of gas retail arrangements.

Conclusion

In this submission Energy Consumers Australia has advanced 11 propositions to assist the work the AEMC. Some of the propositions relate to the details of the national law or jurisdictional legislation. However, elements of the arrangements can be advanced by the AEMC or others before the legislation is changed.

Similarly, there are propositions that require action by other parties, such as the AER or Ombudsman schemes. Energy Consumers Australia encourages the AEMC to take an approach of working with these agencies as part of an overall approach.

In this submission we have not addressed the wider question of whether there should be changes in the distribution of functions in regulating energy sales between the legislation, the rules and AER instruments (determination, conditions and guideline). The law could be less prescriptive and the rules could specify more of the detail on licencing' of sellers. The rules could perform some of the functions currently falling in the purview of the AER, so that the AEMC as market developer rather than the AER as regulator should be determining the exemption categories and the conditions.

The consideration of the allocation of responsibility is probably better considered in a wider review of the retail arrangements.

Any additional inquiries in relation to this submission should be directed to David Havyatt at david.havyatt@energyconsumersaustralia.com.au or on 02 9220 5508.

