

Our Ref: 62079
Your Ref:
Contact Officer: Angela Bourke
Contact Phone: 03 9290 1910

14 March 2018

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted online: www.aemc.gov.au

Dear Mr Pierce

Submission on draft report: updating the regulatory frameworks for embedded networks

Thank you for the opportunity to comment on the AEMC's draft report on updating the regulatory frameworks for embedded networks (ENs). We commend the AEMC on progressing this work following its review of regulatory arrangements for ENs. We welcome and support the vast majority of the AEMC's proposals and flag a small number of areas for further consideration, particularly on the proposed changes to the retail exemption framework.

We support the AEMC's proposals to increase access to competition and to strengthen protections for EN customers. We largely support the AEMC's proposed changes to the market entry framework, in particular the proposed changes to the retailer authorisation framework. The additional flexibility created in the authorisations framework to allow for 'off-market retailers' and for retailer obligations to be varied is important and welcome. The AER has strongly advocated for these changes.

Under the proposed framework we anticipate that energy sales will largely fall under the expanded authorisations framework and as such going forward we anticipate the exemptions framework will be used in much more limited circumstances. We consider there is still some need – albeit much more limited – to exempt certain energy sales from the broader authorisations framework. Over the last few years the energy market has evolved quickly and in ways not previously anticipated. It is therefore essential that the framework regulating the sale and supply of energy is flexible enough to respond to different and changing customer needs and as yet unforeseen energy selling models. The final report of the

ACCC's Retail Electricity Pricing Inquiry aptly pointed out that the energy framework requires more flexibility, not less, if it is to remain relevant and responsive to a changing market.¹

The AEMC has indicated it will detail a process for transitioning existing 'legacy' exemptions to the new framework in its final report. All existing EN customers should benefit from the proposed enhancements to consumer protections and access to competition that will result from the new framework. Therefore, current exempt arrangements should, to the extent possible, be transitioned. We note the large number of customers currently supplied by ENs and that for some EN operators and sellers, the transition costs could be onerous and exceed any potential benefits to customers. We would like to work closely with the AEMC to determine not only who will be transitioned, but the mechanics of transitioning exempt sellers and EN operators to the new regulatory framework.

In this submission we focus on proposals affecting areas administered by the AER that we have concerns about (see **Appendix A**). We have also identified a small number of drafting issues.

We look forward to continued close collaboration with the AEMC on this important work. If you would like more information on this submission please call Angela Bourke on 03 9290 1910.

Yours sincerely



Paula Conboy
Chair
Sent by email on: 14.03.2019

¹ ACCC: *Restoring electricity affordability and Australia's competitive advantage. Retail electricity pricing inquiry – final report*, June 2018: xx.

Appendix A

Obtaining the necessary level of flexibility in the market entry framework

Support for increased flexibility in the retailer authorisation framework

1. ENs serve a large range of customers and purposes, and it is important that the market entry framework, including the authorisation process and applicable customer protections, are flexible enough to meet specific customer needs. As the AEMC has recognised in developing the new framework, the current retailer authorisations framework is inflexible, with set entry criteria and regulatory obligations that cannot be adapted to meet different customer and energy supply needs. The inflexibility of this framework has made it unsuitable for regulating various energy selling arrangements and the AER has relied on the more flexible exemptions framework to deal with new and emerging energy supply arrangements. Individual exemptions, in particular, have provided a way of regulating activities that fall outside the authorisations framework, for example, the sale of energy through power purchase agreements (PPAs). Given this, we have seen a significant growth in the number of exempt entities in recent years – an almost 20 per cent increase in retail exemptions and 31 per cent increase in network exemptions over the last two years.² We consider this has been partly driven by the inflexibility of the authorisations framework, which effectively treats all energy retailers as equal (e.g. ‘one size fits all’) and cannot be tailored to address different business and customer needs.
2. The AEMC proposes increasing the flexibility in the authorisations framework by enabling retailer obligations to be waived and ongoing conditions concerning the satisfaction of entry criteria to be imposed. We welcome these proposals. We suggest further flexibility could be gained by allowing additional retailer obligations that extend beyond entry criteria to be imposed, and being able to create new authorisation categories, and to vary entry criteria for new applicants. We are keen to work through these proposals in further detail with the AEMC.

Retaining individual exemptions will strengthen the new framework

3. We think the proposed changes to the authorisations framework will be suitable for the vast majority of current energy retailing activities. However, there will still be energy supply arrangements that may not be properly catered for in the proposed regulatory framework. Exemptions should continue to play a role in regulating such arrangements. We note the AEMC has suggested a similar approach in its *Interim advice: regulatory sandbox arrangements*, identifying existing retail and network exemptions as possible tools the AER could use to enable trials of new energy selling and supply models.³ The proposal to remove individual exemptions and codify class exemptions may remove this option for sandboxing purposes.
4. The AEMC’s report recommends the authorisation process subsume individual exemptions. We consider this form of exemption still has a place in the new framework. An off-market retailer authorisation may not be able to regulate all different and emerging customer and supply needs. We consider the need for flexible regulatory arrangements will only increase as other unanticipated business models emerge over time. Individual exemptions currently apply to a wider range of

² 3,271 current published retail exemptions and 4,423 current published network exemptions as of 28 February 2019, compared with 2,732 retail and 3,379 network exemptions that took effect prior to 25 February 2017. These figures do not take account of exemptions that are no longer in effect.

³ AEMC: *Interim Advice: regulatory sandbox arrangements*, 7 March 2019: ii, 5–6.

circumstances than on-selling arrangements (e.g. PPAs for solar PV and other forms of distributed energy, and supply to off-grid communities). They have allowed the AER to regulate these diverse selling arrangements in a flexible and appropriate way, balancing consumer protection requirements and risk and regulatory burden. We cannot see this need abating in future, as retail markets continue to evolve and transition. We consider that individual exemptions should remain an important regulatory tool available to the AER, to avoid imposing high regulatory costs for different and new energy sales and supply models to the detriment of customers.

Flexibility in making retail and network registrable exemption classes

5. The AEMC's 2017 final report supported a principles-based approach for the exemptions framework, restricting exemptions in the NERL to where the cost of authorisation would be high compared to the benefits to consumers. It proposed including further guidance on identifying exempt sellers with 'criteria' in the NERR.⁴ We supported this approach.
6. In our experience, one of the problems with specifying exemption classes is that while they may be appropriate at the time, customer needs and energy selling models evolve and over time the classes can become inappropriate or inadequate. Prescribing these classes may not allow for emerging business models and energy selling arrangements. The AER has revised the retail exemption guideline four times since it was first published in 2011. The revisions were largely in response to inadequacies in the defined framework, and were made specifically to address the prescriptiveness of existing exemption classes and to address new or unforeseen types of energy sales.
7. If exemption classes are established in the Rules any amendments (and our experience indicates there are likely to be some) should be able to be made quickly and simply.

Exemptions for gas sales for limited purposes should be retained

8. We understand the AEMC is currently contemplating whether to produce a stand-alone framework for natural gas supply, or attach regulatory arrangements for gas to the electricity framework. While we do not have a specific preference, we note the proposed legislation requires anyone selling gas, including in an EN, to obtain a retailer authorisation. Often gas is sold to customers in ENs for limited purposes, for example, to power cooktops, hot water systems and communal barbecues. It is often unmetered. This type of sale is currently covered by a deemed exemption class in the AER Exempt Selling guideline (retail exemption guideline), with only a few applicable conditions because the risks of poor consumer outcomes attached to this type of sale are low. Given this, we consider it unnecessary to require a retailer authorisation for this type of sale. Instead, this type of sale should continue to be eligible for exemption.

Narrowing scope of energy sales

9. The AEMC proposes converting a number of activities currently regulated under deemed exemptions into registrable exemption classes. They are included as deemed exemption classes because they constitute an energy sale under the NERL, and a supply of energy under the NEL. For a number of these activities the energy sale is small or is regulated through some other means, for example, under a

⁴ AEMC: *Review of regulatory arrangements for embedded networks, final report*, September 2017: viii.

commercial contract or inter-company agreement. In our view some of these activities therefore need only limited or even no regulation. In general, we consider energy sale and supply activities should only be regulated if there is a risk of harm and not simply because there is a sale or supply of energy. We suggest consideration be given to removing low risk energy sales from the legislation by specifying they do not constitute a sale of energy or a distribution system.

10. The AEMC proposes excluding some energy supply activities (currently covered under deemed exemptions) from the definition of distribution systems in the NER, for instance a network that forms part of, is used in conjunction with, is ancillary to, or used to facilitate, the functioning of telecommunication services, data service centres etc. We think the corresponding retail activities should also be considered as being out of scope of the legislation. In our view doing so will have no practical effect on the regulation of these types of sales as many are already lightly regulated (if at all). We would be interested in exploring options for narrowing the scope of energy sales with the AEMC.
11. The table below sets out current deemed exemption classes (with abbreviated definitions) in the retail exemption guideline. It indicates the AEMC's proposed approach to regulating them under the new framework, and our preferred approach. We mostly support the AEMC's proposed approach, with a small number of exceptions.

Current deemed retail exemption classes	Proposed framework	AER preference
D1: Fewer than ten non-residential customers	Off-market retailer	Off-market retailer
D2: Fewer than ten residential customers	Off-market retailer	Off-market retailer
D3: Holiday accommodation	Registrable exemption	Registrable exemption
D4: Temporary selling on construction sites	Registrable exemption	Out of scope
D5: Unmetered gas	General authorisation	Registrable exemption
D6: Unmetered electricity in Queensland	Registrable exemption	Registrable exemption
D8: Related company	Registrable exemption	Out of scope
D9: In conjunction with/ancillary to telco/data centre services	Off-market retailer	Out of scope
D10: Government sales to non-residents	Off-market retailer	Off-market retailer

12. We propose defining the following activities out of scope of the national energy frameworks for the following reasons:

D4: temporary sale on construction sites.

- The draft NER identifies temporary supply on construction sites as not constituting a distribution system. We consider corresponding retail sales should be similarly treated in the NERR given the 'sales' arrangement is temporary and

subject to agreement between contractors. This would be achieved by defining temporary sales on construction sites as not constituting a sale of energy.

D8: energy sales to a related company.

- We consider there is no need to regulate this type of energy sale which effectively involves the sale of energy by a business to itself. As such, it has a natural interest to protect the customer (itself) and there is a very low, or no, risk of harm. This type of sale is included as a deemed exemption class in the current retail exemption guideline because it is captured by the current definition of a sale of energy. However, because we consider there is a low risk of customer detriment, we have not attached any conditions to this class. We recommend it be considered out of scope under both the NERR and NER.

D9: energy sales in conjunction with/ancillary to the provision of telecommunications / information services.

- Energy sales by telecommunications companies or data centres that are incidental to the provision of telecommunications or information storage services are captured by this class. Customers for these services are generally large, the energy sale is incidental to the provision of these services and is covered by contractual agreements between parties with comparable negotiating power. Given this, customers are unlikely to require specific energy related customer protections and we do not perceive a need to regulate this type of energy sale, and recommend it be considered out of scope under the NERR and NER. We also note this type of sale was previously expressly excluded from jurisdictional energy laws.
13. The AEMC proposes adopting the AER's treatment of PPAs under its retail exemption guideline in the new arrangements, including restricting the length of the customer contracts (to be eligible for a registrable exemption PPA customer contracts must be less than 10 years). However, we no longer consider it necessary to limit eligibility for this exemption class based on contract length. Longer contracts are generally offered to large customers and they include exit clauses that are the subject of contractual agreement between the parties. We had intended to remove this eligibility criterion from the exemption class in a future guideline revision.
14. Several other activities for which there are currently deemed exemption classes in the AER Network Service Provider Registration Exemption Guideline (network exemption guideline) are included only because they fall within the current definition of a distribution system. They include the provision of energy for electric traction systems (e.g. trains, trams) and the supply of energy by privately owned electric vehicle charging stations. The first is covered by contractual agreements between large parties with negotiating power who can negotiate the terms of the energy supply, and the second is subject to competitive tension as customers are able to freely choose between fuel sources and charging stations. The new framework includes registrable exemption classes for these activities but we consider there is no need to provide consumers with energy-specific protections and they therefore should not constitute a distribution system under the new framework.

Retaining flexibility in the current NEL and other parts of the NERL administered by the AER

Distribution loss factors (DLFs)

15. NER clause 3.6.2B(2) states the AER must publish a guideline providing guidance on approving DLF methodologies. We do not consider there is a need for an AER preferred DLF methodology and have not chosen to publish such a guideline for various reasons, including that different DLF methodologies are preferred for different jurisdictions, for example because of different network characteristics.
16. Therefore, we propose clause 3.6.2B(2) be amended to state the AER *may* publish a guideline specifying an approach to be taken by ENSPs to calculate DLFs. The proposed NER (section 3.6.3(g)(2)) already provides for instances where there is no AER published methodology so no further alteration is required.
17. Further to the requirement for a DLF guideline, we note the AEMC has translated sections 4.5.1, 4.5.2 and 4.5.3 of the network exemption guideline into the proposed NER section 3.6.3(g1), but section 4.5.4 of the guideline which covers annual audit requirements for DLFs is not covered in the NER. Clause 3.6.3 of the NER specifies a requirement for the AER to approve DLFs annually. The network exemption guideline (section 4.5.4) sets out our requirements for annual DLF audits for customers settled in AEMO's market systems. The guideline does not require annual audits of privately agreed DLFs between large customers that are not used in market settlement systems. Small customers are assigned to the DLF that the LNSP would assign to the customer were it supplying the customer directly. Therefore, there is no need for an audit of these DLFs. These arrangements are unlikely to change and we consider the relevant requirements set out in clause 4.5.4 should be included in the NER. This omission in the NER may alone necessitate publication of an AER guideline. (See additional comments below on the DLF provisions.)
18. We suggest that the new rule should be clarified to specify that ENSPs only need to determine site specific DLFs within their respective networks.

Compliance and enforcement

19. The introduction of off-market retailers will mean existing compliance and enforcement tools apply to a broader scale of regulated entities than they do currently, particularly if existing exempt sellers are transitioned to the new framework and choose to become retailers themselves. Apart from the larger EN sellers, most differ from NEM retailers in size, have less equipped governance structures, and engage in more limited activities given they do not register in the wholesale market. We note that under the new framework the AER will have discretion to direct compliance monitoring and enforcement activities in relation to off-market retailers as needed, by weighing up the relative costs and benefits of compliance and enforcement activities in each instance, as we do for generally authorised retailers. We support this.
20. We support elevating life support protections into the NER to clarify how they apply to EN customers. Information sharing obligations are particularly important in ENs because of the interaction of multiple parties.

Performance reporting

21. The draft changes to the NERL propose off-market retailers must satisfy retailer performance reporting obligations. We will likely need to develop new performance indicators specifically for this new category of retailers which may differ from indicators applying to other retailers. We note the AER will have discretion to develop appropriate indicators for off-market retailers, as we have done for generally authorised retailers. We support this.
22. We anticipate substantial administrative and systems changes to expand the reporting framework to include off-market retailers and any transitioning sellers. While we cannot be definitive about timeframes for introducing these changes, we suggest 2020 or 2021 implementation is likely to be too ambitious given the preparatory work for us may involve large scale IT infrastructure changes, in addition to stakeholder consultation and guideline amendments. We would be happy to discuss this further with the AEMC.
23. To provide some context for the scale of the proposed changes, as at 30 June 2018, 44 active retailers submitted performance reports. From 1 January 2019, these retailers are required to report against 304 indicators. The expected increase in the number of entities likely to be captured under the new authorisations framework will undoubtedly result in a marked increase in data reported to the AER which will require substantial systems capabilities expansion and additional resourcing for the AER.

Price transparency

24. The AER's Retail Pricing Information Guidelines specify requirements for the presentation and publication of retail prices to help customers compare retail energy plans. The draft NERL identifies requirements for off-market retailers to comply with price publication requirements currently applying to retailers. We agree that EN customers should be able to easily access pricing information and compare energy offers, and consider the AER's price comparator website, Energy Made Easy (EME) is the likely vehicle for this, though it may require significant work to accommodate the proposed changes.
25. For example, currently only 'generally available' energy plans are searchable on EME. This does not include EN customer plans, which are not generally available, but limited only to ENs. Under the new framework, if EN customers become eligible for generally available plans, the EME website will require minimal infrastructure changes to accommodate EN customer searches. However, where retailers continue to offer bespoke plans with EN eligibility criteria, the EME platform would need substantial changes to include this information and display it clearly to EN customers. Again, we consider the AEMC's proposed timetable may be ambitious as changes to accommodate bespoke EN plans are unlikely to be completed by 2020.

Legacy arrangements

26. We support the transition of existing sales and supply arrangements to the new framework where possible. Given the large number of exemptions involved (at the time of writing, approximately 3 500 retail exemptions and 5 000 network exemptions), careful thought will need to be given to how this occurs. Some exemptions will not be easily transitioned, for example deemed exemptions and individual exemptions. Deemed exempt sellers do not register and we cannot readily identify them. Individual exemptions have bespoke conditions that differ from authorised retailer obligations and may not be able to be seamlessly transferred to the new framework. We also note that any transition will involve costs for participants

and could have significant resourcing implications for the AER. To ensure the process can be carried out in a manageable and orderly way, we suggest provision be made for a sequenced process, for example, that sellers and suppliers be transitioned in tranches.

27. Retail tranches could be based on customer numbers, for example, sellers with 20 000 or more customers could be in the first tranche, followed by sellers with 10 000 - 20 000, then sellers with 5 000 -10 000 customers and so on. Network tranches could be based on the date of creation of the EN. For example, ENs created from 1 December 2017 onwards could be in the first tranche.⁵ Those created between 2015 and 2017 in the second tranche, and so on. There were approximately 572 embedded networks first registered for exemption between 1 December 2017 and 25 February 2019. Between 1 January 2015 and 30 November 2017, approximately 1 256 embedded networks were registered.⁶
28. While we acknowledge the importance of standardising customer protections, particularly for small energy customers, we consider it may not be appropriate to transition all existing ENs for various reasons. For example, infrastructure changes required to either make the EN NEM-compliant or dissolve the EN and directly connect customers to the grid, may be cost prohibitive. Caravan parks would likely fall into this category. Caravan parks may have two types of customers: short-term holidaymakers and long-term residents. The AEMC's proposed framework has the effect of requiring sites offering only short-term accommodation to obtain exemptions, and those with permanent residents to have authorised retailers sell energy to residents. Caravan park operators may find this onerous and choose to offer only short-term accommodation. The high cost of infrastructure changes in existing parks may also make some parks unviable. Therefore, we consider caravan parks currently exempted should continue to be regulated under the exemptions framework.
29. Other instances where it may not be appropriate to transition sellers and suppliers to the new framework include where commercial incentives to provide energy services are low, and where the costs of regulation outweigh the benefits to customers.
30. We also suggest consideration be given to exempting ENs created with the purpose of sharing the benefits of bulk purchasing arrangements amongst residents or tenants and where all residents or tenants agree to the supply arrangement. These sorts of arrangements are referred to as 'eligible communities' in the network exemption guideline section 4.7. Under the guideline, communities who agree to not appoint an ENM can apply to the AER to be exempted from the requirement. The new framework could provide for a similar mechanism to exempt communities from the new regulatory requirements.
31. The AEMC has indicated it will address legacy arrangements in the final report. We look forward to working with the AEMC to develop workable arrangements.

⁵ This is the date the requirement for an embedded network manager was introduced.

⁶ Figures are indicative as registrations may have been submitted sometime after the embedded network was first created. Figures do not include embedded networks that have changed ownership, or exemptions that may have been submitted prior to 25 February 2019 and have yet to be published on the AER public registers of exemptions. On 1 July 2015, the NERL commenced in Queensland and many network exemptions were submitted around this time for embedded networks that had likely been operating for some time prior to this (e.g. 377 network exemptions for sites in Queensland were registered from 1 July 2015 to 31 December 2015).

Clarifications to proposed legislation required

32. We have identified a number of matters in the draft legislation that require clarification, namely:

Definitions

Activities excluded from the NER – energy sales by telco services

33. Further clarity is needed to identify particular activities excluded from the definition of a distribution system in the NER as follows. The definition in the draft NER states:

The following do not constitute a distribution system:

- ...
- c) *a network forming part of, or used in conjunction with, or ancillary to, or that is primarily used to facilitate the functioning of, infrastructure for the provision of telecommunications services, data centre services or other services provided by means of communications technology, including infrastructure for the provision of internet, telephone, mobile phone, fibre optic, hybrid fibre cable, television, radio or wi-fi services;*

34. The intent of the deemed exemption covering this activity in the network exemption guideline is to regulate the sale of energy *within* a facility not *to* the facility. For example, if an entity runs a data centre within an industrial park, and the data centre charges for energy costs to other businesses it stores data for, the data centre holds the exemption to supply these customers, but the exemption does not apply to the sale of electricity by the industrial park to the data centre.
35. We suggest removing the words ‘forming part of’ in (c), and adding a clarification to specify that a stand-alone facility established for any of the purposes mentioned in (c) within an industrial, commercial, educational, residential or similar facility is a distribution network.

Activities excluded from the NER – rack mounted equipment

36. Clarification is also required to point (e), following point (b) specified above, which states:

- e) *a network forming part of plug-in or rack mounted equipment when in use in any premises including National Broadband Network equipment in any premises with an input current rating not exceeding 3 amps AC.*

37. The wording of the deemed network exemption covering this activity in the network exemption guideline makes clear that only NBN equipment up to 3 amps is exempt. The purpose of this is to cover in-home or business modems or the like. A size limit is imposed on NBN equipment in particular, to prevent the NBN requiring building owners to power major facilities at building owners’ expense.
38. Exemptions for plug-in or rack mounted equipment are not limited to equipment with 3 amps. This should be clarified in point (e).

Exempt activities in the NER – energy sales to educational facilities

39. Apart from the preference expressed above to include exemption classes in AER guidelines, we note in relation to NER clause 2.14.2(b)(7), the class definition is unclear. It specifies:

b) *The AER must only determine a class for the purposes of paragraph (a) where the distribution system owned, operated or controlled by a person who is a member of the class is used primarily for the provision of a distribution service in respect of any of the following activities:*

...

(7) the supply of metered or unmetered energy to non-residential customers, including public and private educational institutions, but only where the person providing the supply is a Government agency other than a housing authority;

40. We note the wording of the deemed exemption class covering this activity in the network exemption guideline varies from the wording in (7), to include all educational facilities, public and private.

DLFs

41. We propose changes to the drafting of NER section 3.6.2B(2) to improve clarity. In particular, this section specifies an AER guideline should provide information and guidance to ENSPs about:

(1) the application of clause 3.6.3 to ENSPs and ENs.

42. We consider the above statement is complete and encompasses the following sections 3.6.2B(2)(2) and 3.6.2B(2)(3). They should therefore be omitted altogether.

Connection services

43. We support the introduction of a connection policies framework for EN customers giving these customers equivalent protections to customers directly connected to the LNSP. We suggest further, that if it is intended ENSP customers should access dispute resolution processes specified under NER chapter 5A part G, this would need to be specified.

Jurisdictional matters

44. We support complementary changes to jurisdictional legislation, in particular changes relating to access to concessions and rebates and improving safety requirements. We suggest changes to building and planning regulations and incentives are also necessary to ensure ENs are only created when in the interests of customers, and that bodies corporate are not locked into long term energy contracts by developers.