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Australian Energy Market Commission

PO Box A2449

Sydney South

New South Wales 1235

By electronic lodgement

**Reference – EMO0036**

### **Draft Report - Updating the Regulatory Frameworks for Embedded Networks**

Watts Energy welcomes the opportunity to respond to the Australian Energy Market Commission's (Commission) *Draft Report - Updates to the Regulatory Framework for Embedded Networks*. Watts Energy is accredited and registered with the Australian Energy Market Operator (AEMO) as an Embedded Network Manager (ENM) and provides meter reading and billing services to embedded networks. Watts Energy supports the Commission's objective to ensure all embedded network customers receive adequate consumer protection and access to competitive and affordable electricity. However, Watts Energy is not convinced that the proposed amendments to the current regulatory framework will achieve the Commission's objectives.

This submission comments on issues raised by the Commission in the Draft Report, with reference to the Energy Objectives and drawing from our experience with embedded networks. Watts Energy has also attempted to provide an indication of potential financial and non-financial impacts of the proposed regulatory framework.

#### *Diversity of embedded networks and customer types*

As noted, there are thousands of embedded networks across the country that come in a variety of different forms. The customers within an embedded network also vary from residential tenants in caravan parks and retirement villages to tenants in a commercial office building or shopping centre (from very large shopping centres to very small local shopping centres). From our experience, most embedded network operators attempt to pass on electricity cost savings achieved through bulk purchasing arrangements to their embedded network customers, as the sale of electricity is an incidental aspect of their business model.

Embedded network customers can be very transient and may be a customer of the embedded network for only a very short period of time (e.g. pop up shops in a shopping centre over Christmas). When a tenant moves out (e.g. shopping centre or office building) the site may also be reconfigured quite quickly and therefore the metering will need to be upgraded or changed quickly to allow for the new tenants to

move in. For example, a large site with one NMI may be reconfigured to allow for a number of smaller shops to take its place.

In addition, third party metering providers will need to liaise with the embedded network owner / operator and comply with any applicable 'working on site' or contractor requirements (e.g. public liability insurance) prior to entry on the customer's site to install or replace metering as well as ongoing reading of meters for the child NMI. Any amendments to the energy laws should be mindful of this new tripartite arrangement and the necessary communication that will be required between the child NMI retailer and metering providers, the customer and the embedded network service provider (or their intermediaries).

This diversity of embedded networks and their customers, as well as the differences between direct connected customers and embedded network customers, highlights the need for a tailored and measured consumer protection and regulatory framework for embedded networks. For example, it may also be necessary to distinguish between residential, small and large business embedded network customers when developing consumer protections.

#### *Promoting Regulatory Certainty*

Watts Energy strongly believes that ensuring regulatory certainty promotes efficient investment in and efficient operation and use of electricity services and is in the long term interests of consumers, as regulatory certainty incentivises market participants to invest in sustainable business models and provide innovative and affordable energy services to meet customer needs and demands.

With the rapid growth of embedded networks has also come the increasing focus on the regulatory frameworks for embedded networks. The Commission's *Power of Choice Review* resulted in the *Embedded Networks Rule* change in 2015 and introduction of the Embedded Network Manager role. This Rule change resulted in significant system and process changes and ultimately costs for the industry.

In good faith, Watts Energy itself incurred costs (discussed below) to obtain ENM accreditation and is concerned that the proposed regulatory changes will effectively mean that these costs will not be recovered and its future business model will be eroded or alternatively it must incur further additional costs in such a short period time. Further, Watts Energy is concerned that its meter reading and billing service will become redundant under the proposed new framework. The costs to the many small businesses (similar to Watts Energy) affected by the proposed changes should be included in the Commission's cost benefit analysis.

#### *Reducing regulatory complexity and transitioning legacy arrangements*

Watts Energy found that there was much confusion in the industry and amongst embedded network owners and operators leading up the introduction of the ENM role. Watts Energy is also currently encountering confusion presently from some retailers as to the correct process to be followed in transferring an embedded network customer to 'on market' and is concerned that any further proposed changes, introduced in such a short period of time, will exacerbate market confusion and possibly result in unintentional non-compliance.

It is noted that the Commission considers that replacing the ENM role with a new role of ENSP will reduce regulatory complexity.<sup>1</sup> However, Watts Energy is concerned that the creation of a new ENSP role for new embedded networks, will initially result in confusion in the market as to roles and responsibilities.

When considering transitioning legacy arrangements, the Commission should be mindful that there are a number of existing contractual arrangements in place between exempt embedded network owners and

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<sup>1</sup> Draft report page 66

ENMs. As such, Watts Energy suggests that the grandfathering of legacy arrangements should be over a number of years.

### *ENSP Registration*

It is assumed that the process to seek accreditation and registration with AEMO as an ENSP will be a similar process and require similar information to an entity seeking accreditation and registration as an ENM or a Distribution Network Service Provider. Watts Energy is concerned that this overlap in market registration will introduce unnecessary regulatory costs, uncertainty and administrative burden to AEMO and the market, leading to inefficient investment and inefficient operation of electricity services.

A possible solution may be to introduce a threshold (e.g. financial or customer types) which above this threshold requires AEMO accreditation and registration as an ENSP. Below this threshold and the person that engages in the activity of owning, controlling or operating an embedded network will be exempt from AEMO accreditation or registration as an ENSP.

Once the threshold question is addressed, an ENSP accredited and registered with AEMO must:

- Also be registered and accredited with AEMO as an ENM (noting that the process of seeking accreditation and registration for both is justified for only those parties who are sufficiently large or meet a certain threshold); OR
- Appoint a third party intermediary to be the ENM (an option for those parties who must be accredited and registered as an ENSP but do not wish to take on the responsibility as ENM and undertake market interface services).

Therefore, you may have the situation where a sufficiently large and sophisticated party is accredited and registered with AEMO as an ENSP (to meet the distributor service standards) as well as an ENM (responsible for the market interface functions) for a particular embedded network area or otherwise they have appointed an Intermediary and sub-contracted the ENM functions. There may also be embedded network owners / operators who fall below the threshold and are exempt from AEMO ENSP accreditation but must appoint an ENM to perform market interface functions.

This solution may address some of the issues in relation to transitioning legacy embedded networks, particularly:

- Existing embedded networks that are subject to AER exemption may continue to be subject to a form of exemption from registration if they fall below a certain threshold;
- Existing embedded networks that are above the certain threshold should have a transition period to seek accreditation and registration as an ENSP and ENM.

Further consultation with affected industry players is required to determine an appropriate threshold that warrants the regulatory oversight and cost of AEMO accreditation and registration as an ENSP.

### *Roles and Responsibilities for ENSP and 'Off Market' Retailer*

The Draft Report provides some information regarding the functions and obligations for both the newly created roles of ENSP and 'off market' retailer. Watts Energy's reading of the Report is that the ENSP will bill network charges to the 'off market' retailer and the 'off market' retailer will bill a single bill (for both network and energy charges) to the 'off market' customer. The 'off market' retailer will also engage a metering coordinator who will be responsible for meter reading services.

The Commission has assumed that often the ENSP and 'off market' retailer will be the same party. However, an 'off market' retailer will need to be authorised by the AER and apply for registration with

AEMO and its obligations will very closely mirror those of an 'on market' retailer.<sup>2</sup> Such significant hurdles for becoming an 'off market' retailer will most likely deter certain ENSPs from also being the 'off market' retailer for the reason that the supply of electricity is an incidental part of their business model and meeting the stringent regulatory requirements will incur significant additional costs. For these reasons, Watts Energy does not believe that a class of 'off market' retailer should be included in the National Energy Retail Law or National Energy Retail Rules.

Watts Energy has serious concerns that customers who have elected and chosen to remain 'off market' (e.g. because the ENSP currently negotiates and passes through competitive electricity prices) will effectively be pushed to go 'on market' as their 'off market' retailer won't be the ENSP, but a third party who is also most likely operating as an 'on market' retailer.

#### *NEM Compliant Metering*

The Commission has acknowledged that there may be impediments to transitioning some exempt sellers fully to the new framework, particularly in relation to the feasibility and cost of upgrading metering infrastructure to be NEM compliant. Should the Commission require metering infrastructure to be upgraded compulsorily then Watts Energy believes that the party being required to bear the cost of the upgrade should also be the party who bears the benefit of the upgrade.

Further, as discussed above, the party upgrading or reading the meter will need to comply with the ENSP's on-site contractor requirements.

#### *Network Billing*

Watts Energy agrees that addressing network billing and producing a single bill to 'on-market' customers will improve retail competition in embedded networks. However, Watts Energy has serious concerns with the proposal for ENSPs and ENMs to undertake network billing as it will increase unnecessary financial risk and costs to ENSPs and ENMs. Currently, Distribution Network Service Providers bear the financial risk of a retailer or customer not paying the network component of electricity charges. However, ENSPs and ENMs may not be able to bear the financial risk of non-payment, or late payment by the retailer as well as paying network charges upfront months in advance and recovering those charges from the retailer at a later time.

Further, the Commission should take into consideration the risk of increased billing disputes, billing errors and oversight with possibly thousands of ENSPs undertaking network billing to retailers.

The Commission has considered the option of an intermediary providing the network billing function, as it would reduce the complexity and inefficient investment from thousands of ENSPs billing retailers (significantly more than the current DNSP / Retailer network billing arrangement) and would reduce the credit support risks and obligation on retailers to pay ENSPs for network charges.

Watts Energy supports the option of a network billing intermediary (e.g. AEMO) for 'on market' customers in both new and legacy embedded networks, as AEMO (or someone similar) already has the system capability and access to metering data. However, this option needs to be further examined and consulted on, including how the costs of a billing intermediary will be recovered from market participants. Further, amendments to Chapter 6B of the National Electricity Rules should also be introduced to oblige retailers to pay the intermediary network charges and if necessary allow the intermediary the option to seek credit support.

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<sup>2</sup> Draft Report page 50

## Costs of compliance

The Commission has noted that networks that currently meet AER network exemptions may incur 'minor additional costs in preparing applications for network registration with AEMO'<sup>3</sup>. The Commission should note that the cost for Watts Energy to meet AEMO registration requirements to become an ENM (e.g. implementing market systems, updating IT hardware, educating staff and documenting processes and policies) was in the vicinity of [REDACTED]

*Confidential information has been omitted for the purposes of section 24 of the Australian Energy Market Commission Establishment Act 2004 (SA) and [sections 31 and 48 of the National Electricity Law/sections 71 and 331 of the National Gas Law/sections 223 and 234 of the National Energy Retail Law.*

Watts Energy incurred the costs to become an ENM on the assumption that it would be able to recover such costs over a period of time. However, before such costs could be recovered the Commission is proposing additional changes, which reduce the ability for Watts Energy to recover these costs. Whilst this cost for a large organisation would be considered 'minor' it is significant for a small business and many of the embedded network owners and operators (e.g. retirement villages, caravan parks and small to medium shopping centres) would consider such costs to be prohibitive.

Further, the Commission should take into consideration the following additional costs that will be incurred by affected market participants when assessing the proposed Rule change:

- ENSP and 'off-market' retailer costs to be registered with AEMO (similar to the ENM costs above);
- Annual audit costs to AEMO for accreditation audits;
- Ongoing compliance costs to educate staff and review and maintain policies and processes;
- Costs to implement and maintain Guaranteed Service Level and jurisdictional rebate schemes;
- Ongoing IT costs to maintain market systems and infrastructure hardware;
- Possible system upgrades to meet network billing requirements;
- Engagement of a Metering Coordinator for off-market connection points (which are highly specialised roles requiring accreditation with AEMO).

The costs below are additional to the market costs involved in any regulatory change such as:

- The number of ENSPs is likely to be in the thousands and will require additional staffing for AEMO to process such applications;
- AEMO's costs in updating market systems (e.g. MSATS) and associated procedures;
- AER's costs in monitoring and enforcing. The Commission notes that the AER's administrative costs in respect to monitoring and enforcement will reduce under the proposed changes<sup>4</sup>, however it is more likely that these costs will increase as the removal of deemed exemptions will mean the AER will have improved awareness of registrable entities and are expected to undertake increased compliance monitoring.

The Commission should also include in its assessment the fact that as each child NMI goes 'on-market', the ability for the ENSP to negotiate attractive and competitive bulk supply electricity arrangements for the remaining 'off-market' customers will reduce, resulting in higher electricity prices for those customers who remain 'off-market'. And it should be assumed that a number of embedded network customers will elect to stay 'off-market' (for the same reason a number of direct supply customers have chosen to not take up a market offer or if the embedded network customer has a good ongoing relationship with the ENSP or if the embedded network customer only expects to be a tenant for a short period of time).

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<sup>3</sup> Draft Report page 46

<sup>4</sup> Draft Report page 56

And as mentioned above, there are those current small businesses or niche service providers who, like Watts Energy, provide meter reading and billing services to embedded networks and we assume their current business model will no longer be sustainable.

#### *Planned Interruptions*

It is noted that the Commission is proposing to introduce an obligation on ENSPs that would require an ENSP to notify affected embedded network customers of a distributor or retailer planned interruption within one business day of receipt of the notification from the Distribution Network Service Provider or retailer. However, currently the AER Retail Exemption Guideline provides that embedded networks have at least two business days to provide such notification.

Watts Energy believes that two business days is more reasonable as one business day would not be adequate, particularly in larger embedded networks.

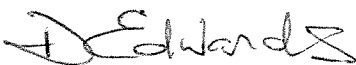
#### *Summary*

Watts Energy has attempted, where possible, to provide financial and non-financial impacts of the proposed changes and requests that the Commission take such impacts into consideration when drafting the new regulatory requirements. Such financial impacts may be considered insignificant for larger organisations but for those ENSPs, where the selling of electricity is an incidental part of their business, the cost to meet new regulatory requirements will be significant and may affect the future viability of those businesses.

The Commission should also be mindful that the proposed new changes will likely create confusion and uncertainty so soon after the ENM role has been introduced. Therefore, it is vital that affected customers and industry players are consulted and kept informed in advance of the changes being introduced. As such, it is recommended that the Commission widen its consultation approach, to ensure the thousands of embedded network owners and operators are provided the opportunity to provide feedback. For many of these businesses, as electricity is an incidental part of their business, staying abreast of electricity regulation is difficult. Therefore, the complexity of the change needs to be proportionate to the risk of harm occurring and not stifle innovation and the benefits being achieved through bulk purchasing arrangements.

Should you have any questions or comments in relation to this submission please do not hesitate to contact either Rachel Leaver or myself on (07) 3216 4509.

Regards



Donna Edwards