20 October 2017

Mr Owen Pascoe
AEMC Director
Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney NSW 2000
Australia

Dear Mr Pascoe

Submission on AEMC Draft Report of the Review of regulatory arrangements for embedded networks

Thank you for the opportunity to provide a submission to the AEMC Draft report of the Review of regulatory arrangements for embedded networks.

Background

Living Utilities is Lendlease's dedicated private utilities business specialising in precinct scale utility solutions such as the embedded network within the Barangaroo South Precinct. Living Utilities provides customers with better outcomes through smart, innovative and cost effective solutions helping create the best places for people to live and work in, today and in the future.

Our purpose is to develop and deliver smart utility infrastructure solutions for property developments, urban regeneration projects, master-planned communities, apartments and retirement living villages in Australia.

A key difference in our approach is to focus on resource productivity through design, in contrast to the traditional consumption model.

Where Lendlease seeks to deploy embedded networks, it bases its decision-making on a number of considerations, including:

- an evaluation of the value proposition to its customers;
- existing and lead-in infrastructure;
- the regulatory requirements;
- price of energy; and
- future deployment of value-add services such as renewables, energy storage and demand management.

Importantly, Living Utilities is well-placed, through our ownership and operation of the Barangaroo South 'open' embedded network, to comment on the risks and issues that may emerge when the broader regulatory changes come into force.

Living Utilities is generally of the view that the changes to take effect on 1 December 2017 should be given sufficient time to see how the market responds.

That said, we are concerned about several negative impacts on our customers arising from the changes commencing on 1 December 2017 which are not addressed within your Draft Report and which are unlikely to be solved by a well-functioning market given what we know. In our view, these issues need to be addressed as expediently as possible – including to the extent that rectification may need to be fast-tracked relative to any other changes arising from this review.

Responsibility to rectify duplication of network charges

The current Network Exemption Guidelines only contemplate that duplication of network charges may occur in the instance that an embedded network is created from an existing electricity distribution system ('Brownfield conversion'). In these instances, the Guidelines place the obligation on to the embedded network service provider (**ENSP**) to remedy any duplication of network charges (i.e. in the event that the retailer continues to charge the embedded network customer for network charges after the embedded network is created.)

The Guidelines, however, are silent about the accountability for remedying the situation where a customer is charged twice for network charges in the instance of a greenfield embedded network and, to the extent that condition 4.9 has been inserted into the Guidelines in the last 12 months (and when combined with the 1 December 2017 rule changes), in the instance of an existing embedded network.

Brownfield conversions to embedded networks

We agree that accountability to rectify duplicate network charges ought to sit with the ENSP in the first instance in the circumstances of a brownfield conversion. However, it is our view that the obligation to 'take steps' required under condition 4.9.5 ought to be considered met if the ENSP issues an invoice to the customer's retailer on payment terms materially consistent with those under the prevailing NUoS (regardless of whether there is a contract between the ENSP and that retailer). Were the retailer not to pay the ENSP within those terms, then the obligation to rectify the duplication should then pass to the retailer. This would practically mean that the retailer would refund the embedded network customer.

Existing and greenfield embedded networks

It is our firm view that accountability for rectifying a situation where duplication of network charges occurs in an embedded network in existence at the time a customer first seeks to go on market or a new 'greenfield' embedded network should sit with the retailer who will have overcharged the customer for charges that they may have no right to collect.

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Let alone having no stated accountability to try to rectify the situation, we are equally concerned that there are no obligations on retailers to minimise the likelihood that a customer may be charged twice – whether by:

- removing network charges from their invoices, or
- communicating with the ENSP to stop it from charging the customer and instead facilitating that the ENSP recovers those charges from the retailer.

Whilst we consider that our proposed accountabilities for each of these situations set out above would be appropriate between the retailer and the ENSP, we are firmly of the view that this will still lead to unnecessary frustration and confusion for the embedded network customer.

Concerningly, there is no obligation on the retailer to let the ENSP know whether it has or has not charged the customer for network charges. In the absence of any awareness as to whether the retailer has or has not, the ENSP will likely charge the customer. There are also no obligations on the retailer to make it clear to a customer on an embedded network that they are on an embedded network and to clearly state whether they are recovering the network charges or not. Retail bills are difficult enough to read and for a customer to deduce themselves whether or not they have been charged their network charges (or, indeed, that network charges are even a thing…) relies upon a level of knowledge about the construct of the electricity market that is unnecessary.

In the instance of duplication of charges, the only way either the retailer or the ENSP will know will be when the customer tells them. This 'telling' is likely to be in the form of a complaint and at the end of a very frustrating experience for the customer, particularly given they may not understand what they are being asked to do.

As such, it is highly foreseeable that the customer will get charged by the retailer and the ENSP and each will claim their entitlement to be paid – possible leading to each party choosing to exercise their rights in the event of non-payment and disconnecting the customer. Customers may end up being the pawns between two parties when there is no need for this to necessarily be the case.

Currently, there is no contract between the customer's retailer and the ENSP. The only relationship between the two is through the customer. Absent a standing agreement with every retailer who may from time to time choose to supply customers within an embedded network, the ENSP will have no contractual basis to recover the network charges recovered by the retailer.

Whilst one may argue that the ENSP ought to go out and seek to get each retailer to execute a form of Network Use of System (NUoS) agreement, our experience is that retailers are either (a) entirely unwilling to contemplate entering into such an agreement or (b) will only contemplate it if the embedded network service provider accept terms which would be plainly unacceptable to a reasonable person. It is quite apparent that there is a significant disparity between the parties in terms of negotiation power.

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The 'competition' promoted by the Power of Choice reforms will not go so far as to have retailers queuing to sign agreements with ENSPs or on terms that have appropriate regard to where risk should lie.

We understand that the Guidelines can only place an obligation on an embedded network service provider; however, the absence of any obligations on the retailers in relation to their dealings within embedded networks and with embedded network service providers, it is entirely plausible to expect that retailers will act entirely in their own interests.

Standard form NUoS

Energy retail law has recently created a harmonized framework where the customer, retailer and network service provider each have a relationship with the other. The principal harmonisation in most jurisdictions was to establish a relationship between the network service provider and the customer – recognizing that a NUoS exists between retailers and network service providers and retailers had supply agreements with their customers.

Within embedded networks (traditionally), there has been a contract between the three parties – recognizing that the ENSP provided both retail and network functions to the customer.

Where a customer chooses to go on market, this creates a contractual gap that will lead to customer frustration and confusion.

As currently contemplated, there is no requirement for a retailer who utilizes the services of an ENSP to supply electricity to their customers to have any form of agreement with them. This relationship outside of embedded networks is triggered the moment a retailer accepts financial responsibility for a customer given an existing NUoS between the retailer and the network service provider.

Further, a network service provider – in the vast majority of instances – will have an identical NUoS with every retailer who accepts financial responsibility for a customer on that network. This is facilitated by the electricity distribution price review process and creates a level playing field between retailers. It also eliminates inefficiency for the network service provider who is compelled to be as efficient as possible and provide a uniform level of service to customers of that network based on their customer classification.

Importantly, however, the NUoS deals with the network service provider's ability to charge the retailer for the network service that it provides. As discussed, the lack of contractual right to recover network charges from the retailer will force the ENSP to recover these from the customer.

Our view is that the AEMC should seek to work as quickly as possible to establish a NUoS that can be established between retailers and ENSPs that address the troublesome gap.

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This NUoS should be:

- standard for all embedded networks
- no more onerous on the ENSP than the prevailing NUoS agreements
- deemed to come into effect at the time that a retailer takes financial accountability for a customer

In doing this, the preconditions for an embedded network customer to only obtain one bill will be achieved. Notwithstanding the conversations that have been had on this topic in the months and years beforehand, it is our view that small customers will always prefer to receive one electricity bill.

Deemed customer connection contract

In the event that a customer in an embedded network were to go on market as a consequence of the 1 December 2017 changes, the current agreement between the ENSP and the customer may not contemplate the ENSP providing network only services.

We believe that it would be a beneficial step if the AEMC were to create a 'deemed standard connection contract' similar to the form recently implemented as part of the NECF retail law changes (DSCC).

Given network services are fundamentally monopoly services, it is an unnecessary burden for the customer to be forced to sign an agreement that they cannot negotiate. Our experience is that the effort needed and the angst created by explaining to a customer that they have to sign a contract where they do not actually have a choice. It would be far better if the contract for these services were a deemed agreement – to the extent that it is materially consistent with the form of agreement appended to, say, the Guidelines and subject to the same publication and notification conditions that apply to the DSCC for network service providers.

In doing so, and when combined with the NUoS arrangements discussed above, the AEMC would create a consistent set of arrangements that are in place for the broader energy market. Importantly, these arrangements would have the effect of minimizing frustration and confusion for customers – noting that much of that frustration and confusion will be exacerbated after 1 December 2017.

Authorised On-selling Retailer

Living Utilities is of the view that the creation of a new class of "retailer", an Authorised On-selling Retailer, as opposed to being an exempt retailer and market customer, may result in traditional utility-scale retailers viewing on-selling retailers as a competitor rather than as a customer. We are concerned that this unintended consequence may result in reduced ability of on-selling retailers to secure competitive supply arrangements flowing onto a reduction in genuine competitive for consumers if the on-selling retailer is not able to secure competitive supply.

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This is consistent with our experience of Retailer behavior in the past, where some Retailers opt out of being a parent meter retailer when notified of on-market customers inside the embedded network. Some reasons provided in the past include:

- problems regarding subtractive metering to establish retail charges; and/or
- cost of managing the market interfaces that is now being assigned to the ENM; and/or
- desire to take all customers off-market to provide parent meter services.

Often underestimated and ignored in the evaluation of embedded network policy, is the value created through the combined purchasing power of the individual embedded customer and the body corporate/owner's corporation. The more sizeable benefits are often realised through reduced operating expenditure and overheads of the common area which flow-on to lower consumer costs rather than being immediately apparent in the individual energy supply cost of each embedded network customer.

Proposed two-tiered regulatory framework

It is Living Utilities' view and experience that the regulatory framework should encourage embedded network owners to invest efficiently in infrastructure and provide customer-focused, differentiated energy services. This differentiation from the normal LNSP/Retailer investment and services should be enabled to drive innovation and better customer outcomes as well as commercial returns to the investor.

The regulatory framework should be careful not to force embedded networks to be replica Retailers/LNSPs as the risks and scale efficiencies do not equate and customer benefits will be eroded. This can be done by enabling appropriate customer protections and appropriate risk/benefit sharing between embedded networks and their customers.

Living Utilities acknowledges the exemption regime reduces the regulatory burden for ENSPs and that a key recommendation for the AEMC's draft report is to re-orient regulatory focus to consumers. Living Utilities urges the AEMC to be mindful that excessive investment in network infrastructure over the past decade is a primary contributor to high energy costs faced by consumers today and as such urges the AEMC to engage thoroughly with ENSPs prior to formulating revised regulatory regime for embedded networks.

In closing the current framework, applied properly by embedded networks, offers significantly aligned protections to those of on-market customers. Ability to access ombudsman schemes would also be beneficial, however the cost of this should be taken into consideration when considering the size of the embedded networks.

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General observations

With all this being said, these proposed changes will only remedy gaps and issues in the environment that has been created by the Power of Choice reforms. They will address issues that are highly likely to lead to customer frustration and confusion, but they will not create a better outcome for customers.

Conversely, each of the changes contemplated by the AEMC – the ones that have come before this review, the ones contemplated by it and the ones we are proposing to address some of the shortfalls – will gradually erode the ability of embedded networks to differentiate. Each will force embedded networks to be a smaller replica of the regulated distribution network service providers.

The requirement to allow customers to be able to go on market and obtain their energy supply from a retailer will constantly make the retailer the center of the energy world – the products that they are prepared to offer customers (within the constraints of the market as it is currently designed) will become the baseline against which the other service providers will have to design their services. Were an embedded network service provider to seek to offer innovative solutions for customers, they will always need to build two solutions – one to meet the requirements of the retailers and the traditional market and one relating to the innovative services they are seeking to deliver to their customers. This inefficiency will likely stifle innovation and may lead to the demise of embedded networks as actors in the energy market.

This, more than anything, is not in the long-term interests of electricity customers.

Thus, we hope that our response to the draft report can add value and assists the AEMC in their review into the regulatory arrangements of embedded networks to achieve a balance between consumer protection, innovation and value.

Living Utilities would be more than willing to discuss these significant issues with the AEMC at your convenience. Please contact Frazer Hill on 0402 088 880 or frazer.hill@lendlease.com for further details.

Yours sincerely,

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CC. Kate Reid, AEMC Senior Adviser

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