Energy Retailers Association of Australia Limited

11 October 2012

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By email: aemc@aemc.gov.au

Dear Sir/Madam

RE: Power of choice – giving consumers options in the way they use electricity – Draft Report

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide comments on the *Power of choice – giving consumers options in the way they use electricity – Draft Report* (the Draft Report).

The ERAA is the peak body representing the core of Australia's energy retail organisations. Membership is comprised of businesses operating predominantly in the electricity and gas markets in every State and Territory throughout Australia. These businesses collectively provide electricity to over 98% of customers in the National Electricity Market (NEM) and are the first point of contact for end use customers of both electricity and gas.

The ERAA congratulates the AEMC on a comprehensive and well written report. The majority of the Draft Report is consistent with ERAA policy, and feedback is provided where we believe recommendations are not in the long-term interest of consumers. Whilst the ERAA has addressed most draft recommendations and questions individually, outlined below are six key overarching points from our submission:

1. Whilst the goal of increasing customer choice is welcomed, it is not welcomed at any cost.
2. *Facilitating consumer access to electricity consumption information* - there has not been adequate consideration of potential legal conflicts between energy-specific regulation and broader Australian privacy laws.
3. *Engaging with consumers to provide DSP products and services* - there is a need for a comprehensive review of third party responsibilities to consumers and an examination of how third parties can be brought under the NECF efficiently and effectively.
4. *Enabling technologies for DSP* - the ERAA strongly supports metering services being open to competition and market driven, however, perceived risks such as meter churn are overstated and misunderstood.
5. *Demand side participation in wholesale electricity and ancillary services markets* - demand side participation is a worthwhile long-term objective, however the ERAA has concerns with the model proposed and would strongly oppose its introduction as drafted.
6. *Efficient and flexible pricing options* – the ERAA supports the introduction of flexible pricing, although the challenge of transitioning customers to underlying variable network tariffs should not be underestimated.

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The ERAA looks forward to further work with the AEMC during this review process. Should you wish to discuss the details of this submission further, please contact me on (02) 8241 1800 and I will be happy to facilitate such discussions with my member companies.

Yours sincerely

Cameron O'Reilly
Chief Executive Officer
Energy Retailers Association of Australia

2. Facilitating consumer access to electricity consumption information

2.3.1 Timely and accessible energy and metering data to consumers

Draft Recommendation
We propose that changes are made to: - Chapter 7.7 (a) of the NER to clarify the requirements on a retailer when consumers request access to their energy and metering data. This would include provisions relating to the format and structure of data to be provided; the timeframes for delivery; and fees that can be charged. - Chapter 7 of the NER to require, at a minimum, a retailer to provide residential and small businesses consumers with information about their electricity consumption load profile. There may be a need to amend the NECF to ensure consistency of arrangements.

The ERAA provides support to this draft recommendation, subject to the conditions outlined in response to questions 1 and 2.

Question 1
What should be the minimum standard form and structure of energy and metering data supplied to consumers (or their agents)? Should these arrangements differentiate between consumer sectors (i.e. industrial/ commercial and residential)?

The ERAA would not support a minimum standard that is highly specific, as this would add costs which would ultimately be passed through to consumers. The ERAA supports the continued use of the NEM12 Data standard. Alternately, we would support a method similar to the Green Button approach where consumers are able to upload their data onto comparator sites.

The ERAA would not support a differentiation between sectors as this will increase the costs of data provision.

Question 2
When do you think it is appropriate for a retailer (or responsible party) to charge a fee for supplying energy and metering data to consumers or their agents?

The ERAA supports a minimum level of free data requests per annum, as is currently the case. Any requests above this level should attract a fee determined by the market. Also, any data requests that do not conform to an industry-agreed format should incur a market-determined fee, as additional requests, specific to unique needs, should be borne by those that request them, and not all customers.

2.3.2 Transfer of energy and metering data to authorised consumer agents

Draft Recommendation
We propose that changes are made to Chapter 7.7 (a) of the NER to enable agents, acting on behalf of consumers, to access consumers' energy and metering data directly from a retailer. This would include requirements on a retailer to provide consumers' energy and metering data to an authorised consumer's agent (third party), following explicit informed consent.

The ERAA does not support this draft recommendation.

Whilst the ERAA supports an industry wide format of data provision, we do not support the provision of data to third parties unless explicit informed is obtained, guided by strict National Privacy Principles (NPPs) guidelines.

In a situation where an agent, acting on behalf of a customer, requests data, it is unclear what the procedure for obtaining explicit informed consent would be. Legally, it is unlikely that retailers would be able to provide data without proof that this consent had been obtained. It is likely that this process will be no easier than the current arrangements where customers request access to data directly from retailers. Retailers have significant privacy obligations under the National Privacy Principles (NPPs) and the National Energy Customer Framework (NECF) and face significant penalties if data is not secure. Third parties requesting data may not fall under the NPPs or the NECF, and so the ERAA is unsure how to AEMC intends to address this difference.

Retailers are custodians of customer data, and are legally responsible should misuse of customer data occur. It is unclear how this proposal will protect retailers from misuse of customer data from third party agents. Whilst we support third parties being able to access customer data (after obtaining explicit informed consent) the AEMC needs to ensure that not only are consumers protected from misuse of data, but also that retailers and networks are exempt from any responsibility (assuming they have adhered to all legal and regulatory requirements), legal intervention that may arise from third parties misusing data. The AEMC must be careful that legal conflicts between energy-specific regulation and broader Australian privacy laws are not be created.

Furthermore, Clause 7.7(a) does not prevent an authorised agent that has explicit informed consent making a request for access to data and for the retailer (the Financially Responsible Market Participant, or FRMP) to then provide them with the data. Whilst some third party providers may be concerned that the requirement to provide some form of authority to access consumer data may not suit their existing operating models, the ERAA does not support developing policy, or imposing costs on consumers, that caters for emerging operating models that cannot operate in existing market frameworks or circumvent privacy concerns raised by retailers. This is counter to competition policy and sets a dangerous precedence to changing rules to meet the interest of a few participants that find the current precautionary measures used by retailers to protect consumer data as cumbersome.

This position is consistent with views communicated to DRET as part of the recent consultations on the development of a consumer information portal (the CEdata). The ERAA is concerned that the approach by some stakeholders has been to automatically propose the development of the CEdata without considering cost implications to both industry and consumers. The August 2012 release of this scoping study report 'Scoping study for a consumer energy data access system (CEdata)' raised a number of issues:

- The scoping study assumes that customers have given third party consent without any appropriate checks and balances.
- The scoping study fails to mention that the Privacy Laws currently governing the way businesses treat data do not apply to entities where annual turnover is less than $3 million.
- The costs of developing the proposed CEdata and its ongoing maintenance costs have been discounted in the report. These costs will be ultimately be borne by consumers, leading to rising energy bills. The ERAA would support a detailed scoping study that takes into account the full costs and benefits of what is proposed by government to alternatives already available in the market.
- The market is already developing consumer portals that will facilitate further consumer access to their data.

- The development of the CEdata is heavily dependent of smart metering. Penetration is only high in Victoria, where smart meters are currently being rolled out.

2.3.3 Market information to develop DSP products and services

Draft Recommendation
We propose that changes are made to the NER to require AEMO to publish market information on representative consumer sector load profiles.

The ERAA does not support this draft recommendation.

The ERAA is uncertain of the benefits of this proposal. Currently, net system load profiles are used as a proxy for hedging residential load. However, due to the nature of this unpredictable load (and the multitude of variables associated with residential loads), retailers attempt to mitigate this risk through deployment of various hedging strategies. Publishing a set of representative consumer sector load profiles may not provide consumers with valuable information, instead risking further confusion. The market is also developing portals that will assist customers download usage data which could then be used by third parties that have obtained explicit informed consent, to use the data to develop load profiles to help them target product offerings.

Question 3
Do you agree that general market information should be published on consumer segment load profiles to inform the development of DSP products and services to consumers?

The ERAA does not consider it appropriate for AEMO to publish consumer segment load profiles. In addition to the reasons outlined in response to Draft Recommendation 2.3.3, the ERAA does not understand how development of load profiles can assist to inform the development of DSP products and services to consumers considering the variability, and unpredictability, of this load.

Question 4
Is AEMO the appropriate body to publish such information, or should each DNSP be required to provide such information particularly where data will be at the feeder level where accumulation meters are installed?

Should such information be published, the ERAA would support AEMO as the appropriate publishing body.

3. Engaging with consumers to provide DSP products and services

3.3.1 Energy services to residential and small business consumers

Draft Recommendation
We recommend that the NECF is clarified to make it clear what arrangements apply to third parties providing “DSP energy services”. This should involve establishing criteria either in the NECF or the AER guidelines on retail exemptions. The criteria could include the circumstances where accreditation (or exemptions) of parties is required and the relevant provisions of the NECF that would apply (i.e. marketing rules, and the relevant enforcement and monitoring provisions).

The ERAA supports the view that third parties should be captured by some form of NECF or retailer authorisation. The ERAA believes there is a need for a comprehensive review of third party responsibilities to consumers and an examination of how third parties can be brought under the NECF efficiently and effectively. The ERAA's position on this issue is outlined in *ERAA Smart Meter Working Paper 5 – Third Parties and Distributors* (Attachment 5). The third party framework contained in this document provides a robust framework to deal with this issue. The ERAA recommends that the AEMC uses this as the basis for developing a third party framework as part of this review. The Draft Report did not contain adequate guidance on this issue, and this impasse must be breached before any further progress can be made.

Of particular concern is the lack of a clear consideration of issues relating to energy as an essential service. A definition of an essential service is lacking, as is an analysis of how non-essential services impact essential services, and how these two categories interact. From the ERAA's perspective, the Draft Report creates the potential for the providers of non-essential services to impact on the ability of the providers of essential services to deliver on their regulatory obligations. Furthermore, retailers as the providers of essential services risk facing penalties in these situations, whilst those providing the non-essential services do not.

3.3.2 Role of retailers and distribution network businesses - engaging with consumers

Draft Recommendation
We recommend that the NER and NECF are clarified to outline the conditions when a distribution network business can engage directly with consumers to offer DSP network management services. This may involve establishing appropriate guidelines/process for the AER to apply and outlining which elements of the NECF apply.

Question 5
What specific criteria could be used to determine whether elements of the NECF (i.e. marketing code) apply to third parties providing DSP energy services to consumers? That is, beyond Australian Consumer Law?

Question 6
What requirements should be in place for these third parties? For example, what should be the form of authorisations/accreditations?

The following is in response to Draft Recommendation 3.3.2, Question 5 and Question 6.

The ERAA provides conditional support to this recommendation. Appropriate ring-fencing arrangements are essential to ensure a level playing field in the DSP market. The current regulatory framework does incentivise a network business to engage in DSP projects. However, incentivising a monopoly businesses with a regulated capital that is demonstrated by demand increases and caveats associated with the cost impost on customers is not an effective incentive in any situation. Where overall performance is measured against operational performance that is the result of capital spend, and where capital spend is the result of regulatory approval, there is no incentive to defer that spending where there are mechanisms for avoiding liability.

The ERAA's position on this issue is explored further in *ERAA Smart Meter Working Paper 3 – Competitive Neutrality* (Attachment 3). The following points are of particular relevance:

- The products and services that can be delivered through smart metering technology do not possess characteristics that would define them as monopoly products and services, such as declining

economies of scale. The contestability of smart metering services and products has been recognised by the ACCC and NER.[1]

- Distributors must be appropriately ring-fenced to compete on equal grounds.
- Where distributors seek to provide non-emergency load control and other forms of demand side participation to relieve the need for network augmentation for peak load (outside the applicable regulatory mechanisms) distributors should first go to the market and engage with authorised parties to deliver mass market demand side response programmes.

In 2012, the ERAA has been working with the Energy Networks Association (ENA) in an attempt to come to agreed policy positions on a number of issues. This exercise has been beneficial, and has resulted in mutual agreement on many issues. In regards to DSP, in September 2012, the ERAA and ENA agreed to the following guideline supporting DSP in the market:

- *Legacy Load Control* - ENA/ERAA support for networks to retain legacy load control, with a more precise definition of legacy load control to be confirmed.
- *Ring-Fencing for Contestable DSP Services* - ENA/ERAA support, with more precise definitions to be confirmed.
- *Locational DSP not covered by RIT-D* - ENA/ERAA agree that networks would consider approaches by retailers to provide DSP and for a working group to develop a set of principles for better engagements with retailers.
- *Broad-based DSP – non-legacy* - ENA/ERAA agree that customers must provide consent for non-legacy broad-based DSP.
- *Broad-based DSP – Trials* - ENA/ERAA agree that networks should continue to have direct relationships with customers for the trialling and testing of broad based DSP.
- *Broad-based DSP* - ENA/ERAA agree that, post-trial and development stage, broad-based DSP should be left first to the market to develop further. However, it was noted that if retailers, or third parties, do not pick up such a product, distributors may still need to provide such services.
- *Broad-based DSP Tariffs* - ENA/ERAA agree that network tariffs (rather than rebates) are more effective in addressing demand constraints and that retailers are the best party to manage this for end use consumers.
- *Broad-based DSP – Non-Trials* - ENA/ERAA agrees that where network businesses wish to offer contestable DSP directly to customers, this should be done through an appropriately ring-fenced entity with the ring-fencing arrangements meeting appropriate regulatory requirements.
- *Access* - ENA/ERAA agree that further work was required to clarify the differences between the various interpretations of access frameworks so that it was clear that multiple parties will have equal opportunity to offer services across the metering infrastructure.

Question 7
Do you agree that existing rules and guidelines should be amended to clearly outline the circumstances when distribution businesses are able to directly contract with residential and small consumers to deliver DSP network management services/programs?

The ERAA would support this amendment as the existing ring-fencing rules do not suit the existing and emerging market. In addition to comments contained in this submission, the ERAA has attached our submission to the AER's Electricity Ring-Fencing Guidelines Position Paper (Attachment 6) which outlines our ring-fencing policy. The submission contains the following key points outlining the ERAA's position:

[1] See page 85 of Accenture (2011) IHD Inclusion into ESI scheme: Final Report, for Department of Primary Industries, Victoria, December.

- Where a service or product is deemed contestable as conceptualised under its decision model that a distribution business be appropriately ring fenced and that all ring fencing obligations proposed in the Position Paper be imposed.
- Distribution businesses should have the ability to apply for a waiver, or variation, to the imposition of a certain obligation, through a public consultation process controlled by the AER.
- This process will ensure sufficient onus be placed on distribution businesses that wish to offer services deemed contestable to the market as to why certain obligations should not be imposed.
- This will alleviate some of the ambiguity that currently exists in the market where distribution businesses offer services direct to customers, and deemed services that the contestable market can deliver, without any appropriate ring fencing provision being considered.

4. Enabling technologies for DSP

4.3.1 Functional Specification of meters in the NER

Draft Recommendation
We recommend that a new minimum functionality specification is included into the NER for all future new meters installed for residential and small businesses consumers. That specification should include, interval read capability and remote communications.

The ERAA supports this recommendation, conditional to details provided in response to question 7 below.

The ERAA's position on this issue is explored further in *ERAA Smart Meter Working Paper 2 – Market-Driven Smart Meter Rollout* (Attachment 2). The following points are of particular relevance:

- The existing type 4 metering framework and metrology provide a sound foundation to support a market-driven smart meter rollout. This framework provides a minimum functionality specification and outlines the minimum service levels that the smart meters would need to meet.
- Beyond this minimum specification, the market will respond to the demand for increased functionality.

Question 7
Should the minimum functionality specification for meters be limited to only those functions required to record interval consumption and have remote communication? Alternatively, should the minimum functionality include some, or all, of the additional functions specified in the SMI Minimum Functionality Specification?

The ERAA supports a minimum level of functionality for metering. However, the ERAA is unsure of the definition of remote communication, and would not support this recommendation without clarification of this issue.

The ERAA does not support a prescriptive approach, instead advocating for high-level specifications. The current minimum service levels and functionalities that relate to type 4 metering requirements are suitable in that specifications should include interval read capability and remote communications. If vendors and metering providers would like to exceed these minimum levels and adopt specifications in the SMI Minimum Functionality, this would be up to them. Most functions contained in the SMI specifications are available in the market today, and thus would be available in a commercial roll out of smart meters.

4.3.2 When should metering infrastructure be installed

Draft Recommendation
We recommend that:
- the installation of meters consistent with the proposed minimum functionality specification to be required in certain situations (e.g. refurbishment, new connections, replacements).
- Such metering must also be installed on an accelerated basis for large residential and small business consumers whose annual consumption a defined threshold.

The ERAA considers that these issues would be addressed under a commercial deployment of smart meters. The ERAA's position on this issue is explored further in ERAA Smart Meter Working Paper 2 – Market-Driven Smart Meter Rollout (Attachment 2). In addition the following points are of particular relevance:

- It is essential that the Responsible Person (RP) is informed of any meter installed on a customer premise.
- It is essential that any accelerated roll out is not mandated, as this will create the same issues experienced by Victoria in the roll out of their mandated AMI Program.
- Whilst the ERAA recognises the current Victorian Government is attempting to address initial implementation issues of the AMI program, clearly mandating an infrastructure roll out is not the preferred model of any government.

4.3.3 Arrangements to support commercial investment in metering technology

Draft Recommendation
Reforms to the current metering arrangements are necessary to promote investment in better metering technology and promote consumer choice. We put forward a model where metering services are open to competition and can be provided to residential and small business consumers by any approved metering service provider.
- If new arrangements are implemented, then we advise that governments should consider removing the possibility of a mandated roll-out of smart meters.

The ERAA strongly supports metering services being open to competition. As has been previously communicated to the AEMC, these views are expanded further in the ERAA's *Smart Meter Working Paper 2 – Market-Driven Smart Meter Rollout* (Attachment 2):

- Competitive metering means better outcomes for customers, such as lower costs and better services without a requirement for a government mandate.
- Competition between retailers underpins the incentives that retailers have to roll out smart meters to their customers and to deliver the range of services and products that customer want at a price they are willing to pay.

Question 8
Does the separation of the provision of metering services from retail energy contracts remove the need for meter churn when a consumer changes retailer? Does this cause any unforeseen difficulties or create any material risk? Are there any alternative approaches to reducing the need for meter churn?

The ERAA does not support retailers separately charging for metering related costs. The ERAA does not consider there to be an incentive for meter churn in a competitive market. There is no evidence to suggest that meter churn is currently occurring or will occur in the future. The ERAA requests that the AEMC

provides further clarity on the motivations behind this question. Should the AEMC believe there is a risk of costly meter churn under a contestable model it should be provided to stakeholders so that there can be informed debate on the issue.

Furthermore, the proposal is problematic as the retailer, as the RP, carries the metering risk. Should the provision of metering services be separated from retail energy contracts, a meter service provider would be acting with an inefficient risk appetite.

The ERAA's position on this issue is explored further in *ERAA Smart Meter Working Paper 2 – Market-Driven Smart Meter Rollout* (Attachment 2). The following points are of particular relevance:

- In 2005, the Australian Competition and Consumer Commission (ACCC) recognised that concerns that retailers would need to churn meters as customers churned were overstated.[2]
- In a situation where a customer churns retailers (for reasons which don't require improved metering functionality), the new retailer will have an incentive to establish its own contract with the previous retailer's existing Meter Provider. This means that retaining the current meter will be more attractive than paying the full cost of a new meter.
- In a situation where a customer churns retailers (for reasons which do require improved metering functionality), the contract with the existing Meter Provider will no longer apply. The existing Meter Provider does not lose any value from a stranded asset because meter providers incorporate the risk of stranding into the original prices. It is also possible that Meter Provider may be able to re-use the asset in another premise.

Question 9 Are there sufficient potential metering services providers to facilitate a contestable roll out of AMI? Does the proposed model mitigate all the material risks of a contestable roll out? If not, should a monopoly roll out be adopted?

A market-driven smart meter roll out would provide a market for metering services providers as was experienced in New Zealand's smart meter market and the introduction of full retail competition for energy in Australia.

The ERAA strongly opposes mandated monopoly roll outs. Risks of a mandated roll out that must be incorporated include the loss of a competitive and innovative market, and the negative experience where customers receive a product they did not ask for, or pay for a product not yet received as was experienced in Victoria.

The ERAA's position on this issue is explored further in *ERAA Smart Meter Working Paper 2 – Market-Driven Smart Meter Rollout* (Attachment 2). The following points are of particular relevance:

- Retailers have a clear interest in maintaining a competitive metering services market because retailers rely on Meter Equipment Provider's (MEPs) to provide a good service so as to deliver the range and quality of service expected by their customers.
- Retailers have commercial incentives to make strategic procurement decisions so that they retain a choice of service provider.
- If service levels aren't maintained than an alternative MEP can be sourced.

[2] Australian Competition and Consumer Commission 2005 Applications for Authorisation: Amendments to the National Electricity Code, Victorian Metering Derogations, P. 26

- This decision relies on there being an alternative MEP able to offer the desired service at a price the purchaser is willing to pay.

Question 10 What should the exit fee when a consumer upgrades it meter from one provided by the local distribution business? Is the proposed fixed 30% of the cost of a replaced meter appropriate?

The ERAA believes that exit fees payable for advanced meters provided by the local distribution business should be determined by their current book value. That is, the current value of that asset as noted in a distribution businesses balance sheet or asset register. For accumulation meters, no fee should be paid.

Where the arrangement is purely commercial, there is no need for any mandated fees.

Question 11 Does the option of a government mandating an AMI roll out within its jurisdiction act as a strong disincentive to a commercial roll out? Should the ability for these governments to mandate an AMI roll out removed from the NEL?

The ERAA would support this proposed amendment to the National Electricity Law (NEL). The ERAA strongly believes that the option of a government mandating an AMI roll out within its jurisdiction acts as a strong disincentive to a commercial roll out as it heightens investment uncertainty and financial risk. No market participant will decide to roll out a commercial deployment of smart meters if there is a risk of a future mandated deployment. Should the risk be deemed low enough that a commercial roll out is possible, the risk premium will be incorporated into the cost structures which may make a commercial roll out less feasible as the product offer to consumers becomes more expensive.

The ERAA's position on this issue is explored further in *ERAA Smart Meter Working Paper 2 – Market-Driven Smart Meter Rollout* (Attachment 2). The following points are of particular relevance:

- At the inception of full retail contestability, regulating metering as a monopoly service was deemed to provide more efficient outcomes given the relative cost, volume and the local presence of distributors for small customers. However, exclusivity for the provision of metering services was originally introduced as a transitional measure to address issues of cost and complexity which would have arisen had competition for metering services been introduced simultaneously with full retail competition. It was anticipated at the time that exclusivity would expire at the end of the transitionary period because of the view that metering competition would facilitate innovation both in terms of the type of meter installed and the way in which meters were read.[3]

5. Demand side participation in wholesale electricity and ancillary services markets

For section 5 of the Draft Report, the ERAA will not provide specific responses, instead providing an overview of our position on DSP in wholesale electricity and ancillary services markets.

[3] Essential Services Commission (Victoria), Essential Services Commission of South Australia, Independent Competition and Regulatory Commission (ACT), Independent Pricing and Regulatory Tribunal (NSW), Office of the Tasmanian Energy Regulator, Queensland Competition Authority, 2004 Joint Jurisdictional Review of Metrology Procedures: Final Report, p. 41

The ERAA does not support the introduction of the proposed demand response mechanism in the NEM. In summary, the costs it will introduce (inefficiencies in the market and increased hedging costs) will outweigh the potential benefits (relating to money earned by energy consumers from not consuming energy). Whilst the AEMC has indicated that unlocking DSP is in the long interest of consumers, this should not be done at the cost of efficient investment and operation of the NEM as highlighted below.

It doesn't pass an efficiency test

The National Electricity Objective (NEO) clearly states that "the objective of the Law is to promote efficient investment in and efficient operation and use of electricity services for the long term interests of consumers..." The AEMC's proposed efficiency test for efficient DSP, being that the costs of subsidising demand response is less than the benefit shared by other consumers from lower electricity prices, is not consistent with the market efficiency principles promoted by the NEO.

The spot market provides short term price signals to both generation and demand. Demand is driven by consumers trading off the benefit of consuming and the cost of doing so. The benefit of demand response to a customer is therefore the avoided cost of paying the market price. This is the conventional market mechanism that defines the efficient level of demand response to price. We all make decisions everyday whether to make a purchase and enjoy the result, or avoid the cost if the price is higher than the value received. Introducing payments to consumers for load not taken is a subsidy for demand reduction and therefore distorts this market mechanism.

The correct test to apply in assessing the mechanism is whether it meets the NEO to promote efficient investment in, and efficient operation and use of electricity, for the long term interests of consumers. The proposed wholesale DSP mechanism is inconsistent with this objective for the following reasons:

1. It is designed to distort the spot market price of electricity which is inconsistent with the objective of promoting efficient operation of the market.
2. Subsidising demand response and distorting the spot market price is not in the long term interest of consumers because it affects outcomes in the related contracts markets which provide longer term pricing and investment signals to customers and generators.

It is not justified by international experience

The proposed wholesale DSP mechanism has been modelled on similar schemes in overseas markets and this used as justification for its adoption here. Whilst the model might support the South West Interconnected System (SWIS) evidence that such a mechanism has been adopted overseas is irrelevant in assessing whether it would increase or decrease the efficiency of the operation of the NEM in Australia.

In fact, the NEM is unusual by international standards in being an energy only market, meaning that generation is paid only for energy sold into the market (and demand pays only for energy consumed). Most of the time, competition ensures that spot prices are established at or around the marginal cost of the most expensive generation required to meet demand. Some periods of very high prices at times of high demand and limited availability of generation are therefore required to ensure that generators recover all their fixed costs and return on investment. An alternative market arrangement such as the SWIS provides separate payments for energy generation and for generation capacity made available to the market. In simple terms, energy payments ensure generators recover their operating costs, while capacity payments meet fixed costs and deliver a return on assets. Energy prices are therefore capped at much lower rates in markets where capacity payments are also made.

In the short term, participants use the prevailing spot price as a signal for the underlying supply and demand balance. This informs generator energy offers and participant decisions to review and adjust contracting positions to manage changes in their market exposure. In the medium term, these price signals can inform decisions around generator plant maintenance and outages. In the longer term, investment decisions rely on signals that highlight the balance between supply and demand. Both contract and spot price trends provide important signals that inform not only the timing of new generation investment but also the type, e.g. base load supply, intermediate, peak response. Participants – existing and prospective - need to have confidence in the robustness and accuracy of these key market signals.

The wholesale DSP mechanism proposed by the AEMC occurs in the SWIS and in overseas markets where capacity payments are made. It is easier to see equivalence between payments being made for available demand response when similar payments are made to generators for available generating capacity. Both would be expected to rise during times of high demand and shortage of supply and vice versa.

In the NEM, customers wishing to engage in demand response, already have the benefit of exposure to much higher energy prices over a few hours each year than they would in a market in which capacity payments are also made. Avoiding consumption during these few, highest priced periods enables a customer to substantially reduce their average annual energy costs. Likewise, generators rely more on a few very high priced periods in the NEM than they would in overseas markets where capacity payments are also made. The proposed demand response mechanism erodes the robustness and accuracy of those price signals. As a consequence, participants relying on these signals can make ill-informed decisions, which reduce the efficient operation of the NEM. On balance, consumption decisions are not going to become more efficient under this mechanism. These adverse outcomes are independent from the level of accuracy of the baseline calculation, though baseline inaccuracies are expected to exacerbate these inefficiencies.

In summary, payments to customers for foregone demand are not appropriate in an energy only market such as the NEM, as customers can already access the full value of demand response at peak times. Contrary to the suggestion made by its proponents, *paying for load not taken at the spot price is not analogous to generation earning the post price. It would be analogous to payments made to generation at the spot price for energy not delivered, but available* (a form of capacity payment for surplus generation capacity).

It is not justified by market failure

Large electricity users with interval metering already have an opportunity to engage in demand response. They can do this by seeking supply contracts that expose them to spot market prices, or with sufficiently shaped time of use pricing structures that demand can be shifted away from higher priced periods, or through demand response contracts with generators or third party aggregators.

Most of these customers are choosing not to do so. It is a mistake to assume this is a market failure. For most customers, price certainty is what they want from their retailer. For other customers that are engaged in demand response, the efficient level of demand response is already being delivered – these consumers are making a rational decision to cease using electricity when its cost exceeds that required for them to maintain profitable production in their business. The benefit of them choosing not to take electricity is its avoided cost. We therefore suggest that efficient market outcomes are currently being achieved in this segment of the market where customers already have a choice whether to engage in demand response. In fact ERM Power recently released in its Annual Report the following statement:

"The business continued to develop its demand response ("DR") capability during the year with a team dedicated to both help customers use power more efficiently and cost effectively, and enhance portfolio risk management. Although still in its infancy, the DR program now has more than 50 MW in the portfolio and will provide benefits to both our customers and ourselves. Our customers will benefit from lower energy and network costs and we will benefit from customer loyalty and lower costs of sales."[4]

For most small electricity users on flat tariffs and with no interval metering, opportunities for demand response are currently more limited. With flat tariffs, the demand response signal is more akin to general energy efficiency incentives at all times of the day. However policies are being proposed in the Power of Choice review which will open up new opportunities for demand response in this part of the market, subject to customer appetite. For example, policies to encourage adoption of interval metering will offer opportunities for distributors and retailers to provide a wider range and choice of pricing structures for customers. These might include a time of use pricing that offer some incentive to shift demand to lower prices periods, or critical peak pricing products for customers who wish to chase the benefits of peak time demand response. The market and customer response to the policy measures proposed to increase opportunities for demand response in the broader mass market should be allowed to develop before assuming any market failure needs to be addressed.

We do not support the approach of reducing market efficiency in the large consumer segment of the market in an attempt to compensate the small user market. If an introduction of the DSP mechanism is planned as a transitionary measure while opportunities for broader demand participation in the market develop, then at best it can only be justified for a limited period. Subsidies are notoriously difficult to remove once introduced. Should the proposed DSP mechanism be introduced, an end date should be pre-defined to minimise long term costs to consumers.

Retailers are not kept indifferent

One of the arguments put forward in support of the wholesale DSP proposal is that retailers are left whole while the costs of administering the mechanism will be less than the market benefits. No detailed analysis has been presented to justify the market costs of introducing the wholesale DSP mechanism. These include:

- A retailer who contracts DSP with its own customer compared with a retailer who contracts under the proposed demand response mechanism does not have the same risk profile.
- Economic costs of distorting the spot market price through payment of demand reduction subsidies to one class of consumer.
- The economic costs of establishing a market mechanism that encourages retailers to systematically over-hedge in the contract market (because they remain exposed to baseline energy consumption).
- Economic costs on the generation sector of the market from distortions to the spot market price and consequently the contract market, the effects of which should also be tested against the NEO.
- Costs to all retailers of complex changes to their energy and networks settlements and reconciliation processes, meter data management systems and to their billing systems that enable them to settle and bill on non-metered consumption during demand response time periods.

[4] ERM Power (2012), ERM Power Annual Report, p.11.

Baseline calculations are always imperfect

The issues outlined above do not even take into account the fact that baselines are always imperfect, a significant additional issue. They are designed to approximate consumption behaviour, which is influenced by a number of external factors whose relative weighing can change with little notice, as highlighted above.

- If the baseline is too high, retailers end up over hedging to manage their prospective wholesale market exposure. This artificially increases the demand for contracts, skewing the resulting market signals and increasing contracting costs. This unnecessarily increases the costs for both the DR customer (whose retailer contract need to adjust to reflect the higher risk management costs) and other market participants also sourcing contract cover. From a market perspective, setting the baseline too high also means the DR customer is "overcompensated" for providing demand response – its response is overestimated because the benchmark reference is not correct.
- If the baseline is too low, the retailer is potentially exposed to the wholesale market price outside of DR intervals. If the retailer deems the baseline too low, then it may not be able to incorporate any increased risk management costs into its contract with the DR customer given that will be referenced to the baseline. The DR customer also has an increased exposure to the spot price during the DR intervals. If its actual consumption is higher than the baseline, then during a DR interval, the DR customer (or its third party aggregator) would need to purchase energy from the spot market to make up the difference. This introduces a new risk to the DR customer – which given consumption can be driven by a number of external factors – changes the nature of the commercial venture.

6. Efficient and flexible pricing options

There are several key restrictions on retailers offering such a tariff to end use customers including elements of retail price regulation and the penetration of interval meters in the small consumer market.

Energy market reform has resulted in governments introducing competition, privatisation and deregulation of parts of the energy industry. Utility companies have now been separated into discrete companies responsible for generation, transmission, distribution and retailing. The final stage of deregulation is the phasing out of regulated energy retail tariffs. Without the removal of price regulation the espoused full benefits of flexible prices and smart meters will be difficult to be realised.

Under the Amended Australian Energy Market Agreement (2006) COAG agreed to phase-out retail energy price regulation per jurisdiction where competition is found to be effective by the AEMC. With the exception of Victoria, every State and Territory government is yet to phase out regulated retail prices. Retail price regulation is inefficient; it stifles product innovation, impedes price and service competition, and prevents the full range of benefits resulting from competition from being realised. Competition offers the best form of protection to consumers, not setting retail price caps.

Victoria phased out regulated retail prices on 1 January 2009 following the advice of the AEMC that competition was effective. Since then, competition has developed strongly; offering customers more diverse and innovative energy products, and consumers can save on their power bills by shopping around. Victoria's market is the most active in the world, with switching rates being consistently greater than 25%. This is substantially more than other markets in the NEM which have not yet deregulated retail energy prices. Furthermore, the Victorian market has the least concentrated market share in Australia, where non-incumbent retailers have been able to secure one quarter of the market.

The AEMC has claimed that it "does not agree that retail price regulation should discourage retailers from introducing innovative time varying tariffs" [5] whilst also recognising that price regulation does add to compliance costs and reduces flexibility for retailers. The ERAA disputes this statement. Price deregulation does stifle innovation as price deregulation distorts market efficiency and introduces material risk to retailer operations. Setting inaccurate tariffs could be detrimental to both energy retailers and consumers. If prices are set too high, consumers could pay too much for energy, although competition from market contracts could mitigate this risk. If prices are set too low, retailers will be unable to recover costs and may discontinue operating in the market. Furthermore, there are documented dangers of price discounting to households when actual price rises are later applied. As a result of these challenges retailers are always cautious about introducing innovative tariffs in markets where exposure to financial risk is heightened by price regulation intervention or threat. The best way forward to mitigate such challenge is to promote strong competition in the retail energy market and to deregulate retail energy prices.

State and Territory regulators around the country have indicated that as the energy industry transitions to a low-carbon future, setting cost-reflective (as they are required under their terms of reference) under regulated retail tariffs is becoming increasingly difficult. Once all states commit to the deregulation of retail prices then this will facilitate the transitioning of customers onto innovative flexible tariffs that will shift consumption to lower cost time periods. This of course assumes that all customers also transition onto interval meters, the second restriction on retailers offering effective TOU tariffs.

One of the benefits of interval meters is to better reflect the changing cost pressures on distribution businesses (i.e. flexible network tariffs). Once a customer has an interval meter installed, a transitionary period should then apply to allow customers to test various retail tariff offerings that incorporate these network prices. During this transitionary period customers should have the flexibility of moving from a flexible tariff, back to flat tariff arrangements, allowing for reversions in underlying network tariffs that support retail tariffs. Coupled with allowing for reversions during the transitionary period, policy makers should consider using the current weighted average price control measures that apply to network companies, as a means of slowly transitioning all customers onto network flexible tariffs over an extended period of time.

6.3.2 Building consumer confidence through education

Draft Recommendation We recommend that governments and industry work together to educate consumers and provide them with the information they need to understand both the system wide benefits and potential individual gains from time varying tariffs.

The ERAA supports this recommendation.

Where new pricing arrangements are justified, they need effective customer education and engagement and should deliver identifiable consumer benefits (noting the differentiation of consumer segments) in a timely manner.

The ERAA notes that certain progress is already being made to build on consumer awareness. As example, the AER's price comparator website www.energymadeeasy.gov.au will provide information on costs and use of appliances, as will other government websites, such as the Department of Climate Change and

[5] AEMC (2012), Power of choice – giving consumers options in the way they use electricity – Draft Report, p.111

Energy Efficiency's site www.livinggreener.gov.au. Many energy retailers also already provide this information.

As time of use tariffs become more widespread we can also expect retailers to more actively promote energy saving suggestions and information to best make use of the opportunities available to shift load. For example, information portals showing customer consumption and cost in a clear and easily understood manner are an example of services that can be provided by energy retailers.

It is essential that information provided to customers is done so through their existing retailer. Multiple points of contact have the potential to create consumer confusion ('consumer schizophrenia') which would extenuate the poor perceptions already experienced in the Victorian market with the AMI program. The ERAA though must stress that it considers education separate to information provision, where the former is a shared responsibility of all industry participants, inclusive of government, however information provision is facilitated by retailer involvement.

6.3.3 Managing the impacts on vulnerable consumers

Draft Recommendation
To manage the impacts on vulnerable consumers we recommend that:
• Arrangements are put in place for consumers, which may a limited capacity to respond, to remain on a retail tariff which has a flat network component, and would have the option to choose a time varying tariff.
• Government programs target advice and assistance to these consumers to help manage their consumption.
• Governments review their energy concession schemes so that they are appropriately targeted.

The ERAA supports this recommendation.

Government should look at supporting these customers through some forms of transfer payments. Retailers' ability to price competitively and efficiently should not be confused with any hardship assistance – the Retail Code already deals with this.

6.3.5 Phasing in time varying pricing

Draft Recommendation
The transition to better price signals in the NEM should be done in a gradual phased approach. We propose that this can be achieved through:
• Focusing only on introducing time varying prices for the network tariff component of consumer bills. Retailers would be free to decide how to include the relevant network tariff into their retail offers; and
• Segmenting residential and small business consumers into three different consumption bands and applying time varying network tariffs in different ways. This would work as:
- For large consumers (band 1), the relevant network tariff component of the retail price must be time varying. This would require these consumers to have a meter that can be read on an interval basis.
- Medium to large consumers (band 2) with an interval meter would transition to a retail price which includes a time varying network tariff component. These consumers would have the option of a flat network tariff.
- Small to medium consumers (band 3) would remain on a flat network tariff. These consumers would have the option to select a retail offer which includes a time varying network tariff, if they so choose.

Question 18 Do stakeholders agree with our approach for phasing in cost-reflective pricing? If not, how can the policy be improved to transition to cost-reflective pricing?

Question 19 Have we identified the main issues with transitioning to cost reflective pricing? If not, what other issues need to be considered?

Question 20 How should consumption thresholds be determined?

This response refers to Draft Recommendation 6.3.5 and Questions 18-20.

The ERAA is uncertain how this will work in practice, and requests that the AEMC provides further details to stakeholders so there can be appropriate consultation on this issue. In the absence of these details, the ERAA's preliminary position would advocate for the introduction of two consumption bands as opposed to the three as suggested in Draft Recommendation 6.3.5. This is motivated by a desire for simplicity, and a concern for operational issues that will result as customers move from one band to another.

It is essential that retailers are not left absorbing costs as they cannot pass through the network tariffs (or premiums applied to flat tariffs to mitigate any mismatch) to consumers on existing commercial arrangements. The AEMC must recognise that transitioning customers to an underlying TOU network tariff may not result in the correct price signals being sent to consumers. As customers have a choice as to whether to explicitly consent to a TOU retail tariff that mirrors an underlying TOU network, if consumers elect to remain on a flat tariff then the price signal is muted.

The ERAA supports the following position outlined by the AEMC on page 101 of the Draft Report: "We recommend that consumers above this threshold are required to be charged a price which includes a time varying network tariff. This does not necessarily mean that these consumers will be required to face a time varying retail tariff, as retailers may decide to package the time varying network tariff into a flat retail rate, which may include an appropriate risk premium. Competition in the retail sector will promote consumer choice in this regard. It may also mean that such consumers may not be able to access the regulated standing offer, if that is expressed as a flat retail tariff."[6]

The ERAA would like the AEMC to also acknowledge that flat retail tariffs will potentially increase as premiums are applied to account for the risk introduced by time varying network tariffs. The ERAA would be concerned that as this situation eventuates stakeholders may be keen to introduce further regulatory intervention to protect consumers on flat tariffs, further distorting market efficiency.

Whilst the AEMC has proposed various measures to protect consumers transitioning onto TOU tariffs, such as the proposed bill protections mechanism the ERAA seeks that further consultation is sought on such measures. The proposed bill protection mechanism would result in operational complexities, resulting in costs which would be passed through to customers. Retailers will need to change billing systems to account for the separate retail price structures and associated potential network tariff considerations. This would involve new reconciliation processes following a request for billing using a different tariff structure under the same contract.

[6] AEMC (2012), Power of choice – giving consumers options in the way they use electricity – Draft Report, p.101

The ERAA does not discount that bill protection is a worthy product to help protect consumers, rather that the market should be left to develop such products. Competition will ensure consumers' transition to companies that offer these services as part of their product offerings.

6.3.6 Strengthening arrangements for network tariffs

Draft Recommendation
We recommend that:
- The distribution network pricing rules in the NER are amended so that distribution network businesses have sufficient guidance to set efficient and flexible network tariff structures that support DSP.
- A new provision is included in the rules which require distribution network businesses to consult with consumer groups and retailers on their proposed tariff structures each year.

The ERAA provides conditional support to the recommendations. The support is provided conditional that where a network tariff that is proposed during the consultation phase is rejected by either the consumer groups or retailers, that the network does not continue to proceed with implementing the flexible tariff. This is in particular as customers classified in different bands may not explicitly consent to the retail tariffs that comprise these flexible tariffs which will mean that retailers will have to bear the costs of network tariffs that will not be marketable, or more likely than not pass this risk onto consumers through higher premiums.

Question 21
We seek stakeholder comments on appropriate pricing principles for distribution businesses and the appropriate time period for stakeholder consultation on distribution network pricing proposals.

The ERAA supports the recent proposal put forward by IPART to the AEMC to amend the annual network price setting arrangements in Chapters 6 and 6a of the NEL. The current timetable for network pricing doesn't provide retailers with enough time to set retail prices, with an inadequate period between when determinations are finalised and network prices are notified. This means that retailers are forced to rush retail price setting decisions into a period of days or alternately to base pricing decisions on draft determinations and estimated network tariffs. The ERAA supports bringing forward the publication date of distribution prices.

6.3.7 Addressing risks for retailers under cost reflective pricing

Draft Recommendation
We recommend that once a residential and small business consumer has a meter with interval read capability, that consumer's consumption should be settled in the wholesale market using the interval data and not the net system load profile. This will be the case irrespective of whether the consumer has reverted to a flat retail tariff.

The ERAA is unclear of the intention of this draft recommendation as this is the current practice. It is our understanding that consumer consumption obtained from accumulation reads is currently settled in the wholesale market using net system load profiles whilst where consumption data is obtained using interval data, this is used for settlement purposes.

7. Distribution networks and distributed generation

7.4 Distributed Generation

Draft Recommendation b) Ability of DNSPs to own and operate DG We recommend that the AER should give consideration to the benefits of allowing distribution network businesses to own and operate DG assets when developing the national consistent ring fencing guidelines for these businesses

The ERAA provides conditional support to this draft recommendation. However, the ERAA does not support that distribution generation assets owned by DNSPs should be allowed to be sold to the market as part of DSP. DNSPs are not subject to the same conditions as market participants and offering them privileges under ring fencing guidelines contravene Competition Principles Agreement agreed to by COAG in 1995 – the foundations of today's market.

The ERAA though support that DNSPs utilise DG as part of their demand management programs to offset energy consumption restricted to the office buildings or depots that a DNSP owns and operates.

Draft Recommendation c) Feed in tariffs and value of export from DG units We consider that SCER should, in developing a national approach to feed in tariffs, take into account the value of time varying feed in tariffs to encourage owners of DG to maximise the export of their energy during peak demand periods

The ERAA supports this recommendation.

8. Supply chain interactions

8.3.1 Alternative approaches to facilitate efficient DSP

Draft Recommendation The recommendations are a package of integrated reforms for the market. If implemented, the market should have time to adjust and transition to the new environment. There should be ongoing monitoring and evaluation of the market for the desired outcomes to be achieved. We therefore do not consider that additional regulatory mechanisms beyond those recommended in this report are needed for the market at this time.

The ERAA supports this draft recommendation.

Realising the benefits of smart meters for consumers and industry

ERAA smart meter Working Paper 1

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Realising the benefits of smart meters for consumers and industry

Energy Retailers Association of Australia (ERAA) smart meter Working Paper 1

Energy retailers are enthusiastic about the new ways the industry can meet consumers' needs via smart meters, particularly in the current environment of rising energy costs. Smart meters are replacing technology that is many decades old, and they will enable a long term digital evolution of consumer choice in the energy sector. Smart meters and associated communications technology provide a foundation for a new suite of retail energy products and services which enable real demand side participation in the energy market. This allows consumers to choose different pricing packages to suit their lifestyles, become better informed about their consumption and drive further innovation in energy service lines.

The benefits from smart meters and associated technology are not solely related to retail energy services, they will have a positive impact across the whole energy value chain. This includes allowing for better network planning, where distributors can work with retailers to develop energy products that reduce the burden on the network at peak times. Consequently, network augmentation can be delayed or reduced, thus reducing the impact of network charges on consumers' energy bills.

This paper provides an introduction to the benefits of smart meters, proposing several policy matters that the ERAA believes should be addressed if these benefits are to be realised. This paper is also the first in a series of papers released by the ERAA on smart meter policy issues, with further papers discussing:

- managing smart meter rollouts and meter ownership to maximise competitive pressure and responsiveness to consumer needs (*Working Paper 2*);
- competitive neutrality and the importance of ring-fencing monopolistic services from competitive services to ensure consumer benefit (*Working Paper 3*);
- privacy of personal information and how appropriate use and disclosure of smart meter data can be provided for (*Working Paper 4*); and
- third party and distributor sale of energy management services, and the regulatory changes required to ensure a consistent consumer protections regime and experience across different service providers, allow for consumer recourse in the event of any problems (*Working Paper 5*).

Consumer benefits from smart meters

Conventional electricity accumulation meters are usually read every three months, providing a consumer's retailer with one value for the previous 90 days' electricity consumption, which is generally charged on a flat rate. Remotely read interval meters (smart meters) change the availability of electricity consumption data from one value per 90 days to closer to 4,320 values in 90 days, as the meter stores the consumer's consumption data per half-hour. The availability of near real-time consumption data provides significant value to consumers and industry, as the information obtained allows consumer preferences to be better understood, and met, by retailers' products and services. As consumers learn about the cost of their energy

consumption in near real-time, they can change their consumption patterns to reduce their energy bills. This may include responding to cheaper times of day to use energy, or using load control products or targeted energy efficiency measures. Remote reading through wireless technology creates further benefit by improving bill accuracy and timeliness (and reduces consequential costs) through the elimination of estimated readings that sometimes occur with physically-read meters when the meter reader cannot obtain access to a property. Also, the cost to the consumer will be reduced by removing the need to have physical, on-site meter reading.

As energy consumers learn more about managing their energy use, they will change their expectations of the energy industry and will be proactive in demanding more from their energy service providers. Cost of living pressures, awareness of carbon costs, and increased use of digital technology will provide impetus for consumers to investigate and take up new products that help them understand and control their energy use. In the short term this might be limited to information only about household usage via devices such as in-home displays or Internet web portals, but in the medium to long term might lead to extensive use of time-of-use tariffs, load control products (where an energy service provider might cycle or turn off appliances in the home at peak times) and a greater uptake of small scale generation alternatives such as solar energy, and eventually battery power via products such as electric vehicles. In the longer term, the use of smart meters and new technologies will ultimately concentrate the power of choice on the consumer and empower them to control when, how and how much energy they want to consume, and which supplier or suppliers they want to source it from.

Looking to the future, we can expect energy consumers in ten years' time to be quite different from those today, with a focus on sustainability and energy-conscious lifestyle decisions:

> *The average Gen Y, Mr. and Mrs. Consumer will be in the middle of building their energy efficient house. Such a build will include insulation and design to maximize warmth during winter and minimize heat during summer. It will include at least two forms of self-generating renewable energy sources, with extra capacity-receiving grid input tariffs that neutralize all energy consumption costs. The home also will include smart devices that talk to the smart meter or Internet, and these devices will understand the time-of-use (TOU) consumption and feed-in tariffs that Mr. and Mrs. Consumer have heavily negotiated with their retailer. Using predetermined policies, and TOU tariffs, the devices will regulate energy consumption to minimize costs. They set and forget the daily management of these devices and instead rely on an energy portal that alerts them when normal energy levels are being exceeded and provides intelligence to suggest policy changes, different tariff structures or a different retailer.*[1]

It should be noted that vulnerable consumers will not be left out of the smart meter product suite: there is a real opportunity for all consumers to be better informed about their energy use and benefit from smart metering. Studies have shown that benefit from flexible or time-of-use products is not limited to specific consumer groups, and a study for the Victorian government that used actual consumer data found that vulnerable consumer groups have almost the same potential to benefit as the average electricity consumer.[2]

In the event that a consumer does not want or cannot benefit from a flexible tariff, smart meters enable clear consumption feedback and end the days of the "bill shock" that comes from an unanticipated high bill for the past quarter's use. Retailers also already have hardship policies in place and work with consumers to provide assistance via payment plans and energy efficiency advice and assistance. The availability of

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[1] IBM, (2011) *The Future in Delivering Energy to the "Smart" Consumer*, Andrew Weekes, at http://public.dhe.ibm.com/common/ssi/ecm/en/euw03046usen/EUW03046USEN.PDF

[2] Deloitte (2011) *Advanced metering infrastructure customer impact study: Final report*, for the Victorian Department of Primary Industries, 18 October. See http://www.dpi.vic.gov.au/smart-meters/publications/reports-and-consultations.

comprehensive data on consumption can only help retailers' processes to assist consumers in need and help target more appropriate means of supporting a consumer.

In summary, smart meters and associated technology provides near real-time feedback to consumers about their energy use. This opens up a new range of options for consumers to manage their energy costs and their overall energy consumption and should result in savings compared to basic accumulation meters. Studies have shown that smart meter programmes (with communications technology that provides clear feedback to consumers) have delivered energy savings of 5 to 15 per cent and sometimes even as high as 20 per cent.[3]

Industry benefits from smart meters

Smart meters not only deliver consumer benefits, they also benefit energy retailers and the energy industry as a whole. It is inaccurate to say that retailers only want to maximise consumption and so do not support smart meter technology and products. Retailers have moved well beyond such a characterisation, with several retailers selling solar systems (thus reducing consumption from the grid), and many more actively engaged in energy efficiency initiatives with their consumers. It should be recognised that there is value to a retailer in offering these products that can offset the lost value from lower consumption. Further, the financial gains to a retailer are more around how it manages its trading and contracts in the wholesale market than in the absolute units of energy sold.

In fact, the shift from once per quarter to half-hourly readings provides significant value for retailers, as they develop the right products and information resources needed to meet consumer choice, manage risk and debt more effectively. Further, the technology allows retailers to partner with distributors to offer consumers demand side management contracts for services such as direct load control. Accuracy of bills is also another benefit to industry as well as to the consumer. Estimated bills are problematic for retailers as they lead to bill inaccuracies and consumer dissatisfaction, which can also lead to complaints, as well as an unclear picture of a retailer's overall debt position. This unnecessary cost will be reduced when meters can be remotely read.

Realising the benefits: ERAA policy positions

Retailers support smart meters and are keen to explore new opportunities with consumers and distributors to share the benefits that flow from smart meter programmes. However, these benefits are not guaranteed: there can be a range of outcomes depending on the way that a smart meter rollout is introduced and the nature of the communications with consumers before, during and after a rollout. Given the often significant investment by the community in smart meter projects, the ERAA sees it as incumbent on policy-makers and the industry to maximise these benefits through best policy and practice. The following principles should be employed if this is to occur, where the detail of these positions forms the basis for the ERAA's further smart meter policy papers.

[3] European Smart Metering Industry Group (ESMIG)(2009) *Empowering people for a better environment: A Guide to Smart Metering.*

1. Smart meter rollouts should be consumer-focussed and retailer-led

The full expression of consumer preferences in the smart meter space will take time to develop, which is reasonable given the paradigm shift required of consumers in understanding the changes and engaging with the industry. It is particularly important that consumers are at all times the focus of smart meter programmes through clear education and consumer-focussed product development. This means that smart meter rollouts cannot be seen as technical or infrastructure exercises only.

Reporting on findings from a comprehensive analysis of smart meter programmes and pilots covering over 450,000 residential consumers, industry expert VaasaETT says "The central difference we found between pilot success and failure is the ability of the program designers to meet consumer needs through the demand side program". Success was not purely a technology matter, the technology was there to support to consumer engagement. As stated by the President of United States power company PG&E after the company undertook a smart meter pilot project in 2010:

> *"We thought we were undertaking an infrastructure project but it turned out to be a consumer project".*[4]

Experience to date clearly shows that if consumers are not engaged, and if a smart meter rollout is perceived as purely a costly imposition, the consumer benefits are unlikely to be fully realised.

This means that smart meter rollouts need to provide clear and consumer-focussed information and be as gradual as necessary to manage consumer concerns and provide time for customers to adjust. Best practices reveal that consumer education should start before smart meter deployment using a staged messaging strategy, leveraging internal education and community outreach to promote awareness and acceptance.[5]

Given retailers in the Australian energy industry are responsible for managing the consumer relationship, the ERAA is of the view that retailers are best positioned to manage consumer engagement. This is the only way to ensure that a smart meter rollout is not just an infrastructure project and have it meet consumers' expectations and needs. International evidence shows that energy providers need to consider multiple channels when educating consumers about smart meters and associated products, attempting to influence consumers across all demographics in an informed and targeted way.[6] Retailers are the only parties that can achieve this. Leading from this, the ERAA believes that market-led smart meter rollouts have the best opportunity to meet smart meter policy objectives, as we discuss further in *Working Paper 2.*

It is also important that the appropriate provisions are in place to separate services provided by the competitive market from services provided by monopolies and funded through regulated revenue. This is the fundamental premise of National Competition Policy and the energy market development to date, but it may need reinforcement in the smart meter environment, as discussed in *Working Paper 3.* Consumer benefit largely depends on the cost efficiencies and innovation from competitive tension in service provision, and this benefit will not be fully realised where monopolistic infrastructure businesses manage or control a smart meter rollout.

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[4] VaasaETT (2011) *The potential of smart meter enabled programs to increase energy and systems efficiency: a mass pilot comparison*, Short name: Empower Demand, page 3.

[5] 2012 State of the Consumer Report, Smart Grid Consumer Collaborative (USA) January 23, 2012, page 8.

[6] IBM (2011) *The Future in Delivering Energy to the "Smart" Consumer*, Andrew Weekes, at http://public.dhe.ibm.com/common/ssi/ecm/en/euw03046usen/EUW03046USEN.PDF.

2. *Consumers should have a consistent experience and be covered equally by consumer protections and privacy law*

Smart meters and associated technologies have opened up perceived opportunities to businesses seeking to enter the household energy market, and a range of new service models have been proposed where third parties access consumer meter data and even provide battery (or electric vehicle) charging or load control services. A number of distributors are also suggesting that they should be able to compete to provide these services.

While retailers welcome the opportunity for further competition, ERAA members are concerned that the current regulatory framework is no longer appropriate for these new services. The National Energy Customer Framework and other state licensing frameworks only cover the distribution and sale of energy, not the provision of energy management services, which means that providers of these other services are not covered by this regulation and neither are their customers. For example, a customer of a licensed or authorised energy retailer providing electric vehicle charging will have recourse to the industry Ombudsman and a range of other rights in how they are contracted with, but that customer's neighbour under contract with a third party providing the same service will not. Retailers are concerned about the implications of this situation, as it does not promote equal treatment of consumers or of market participants.

Working Paper 5 addresses the issue of third parties and distributors in the new environment, recommending that the National Energy Customer Framework and other state licensing frameworks are amended to provide specific authorisations for certain service provider types. The ERAA proposes that the overriding consumer protection principle should remain, which is that regulatory frameworks should reflect community expectations about how consumers are supplied with an essential service.

Similarly, we note that there is inconsistency in how privacy regulation covers providers of these currently unregulated energy management services. The National Privacy Principles (NPPs) apply to all existing retailers and distributors, but they do not apply to businesses with an annual turnover of less than $3 million. What this means is that there could be a range of parties seeking to use or disclose consumer information that will have access but not be held to the same standard as existing industry participants. This is likely to be of concern to the community as well, and it can be expected that privacy concerns will escalate as consumers become more knowledgeable about the capacity of smart meters and associated technologies and products. Working Paper 4 addresses privacy issues, leading to an ERAA position that all businesses handling consumer meter data should be subject to the NPPs, regardless of size, and this must be provided for by relevant governments.

About the Energy Retailers' Association of Australia

The ERAA is the peak industry body which represents the core of Australia's energy retail organisations. Membership is comprised of businesses operating in the electricity and gas markets in most Australian states and territories. Collectively, our members provide electricity to more than 98 per cent of customers in the national energy markets and are the first point of contact for customers of both electricity and gas.

Enabling a market-driven smart meter rollout

ERAA smart meter Working Paper 2

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Enabling a market-driven smart meter rollout

Energy Retailers Association of Australia (ERAA) smart meter Working Paper 2

Introduction

This paper sets out how retailers could lead a rollout of smart metering to small customers without the need for government intervention, while operating in a competitive market and maintaining customer choice. The paper works through some scenarios to show how such a market-driven rollout could work and addresses some of the perceived issues and commonly asked questions from a competitive metering and services model.

The "market-driven" rollout model presented in this paper is very different to other rollouts experienced in Australia, particularly Victoria. The rollout is commercially led rather than due to a mandated or regulated undertaking. The model assumes that anyone could make a decision that installing a smart meter would result in benefits — customers; retailers; distributors; meter providers; third party service providers. However, the retailer as the Financially Responsible Participant for a premise is the party that coordinates the installation of the meter and the provision of meter services, such as meter reading. It is important for the prudential stability of the electricity market that retailers are ultimately responsible for the metering arrangements at a premise. A meter does not just determine the customer bills but settlement between the retailer and the market, and the commercial arrangements between the retailer and the network. Determining who is responsible for, and who can own, the meter is important to the operation of the market and to innovations that benefit customers.

The key advantage of the model is that competitive metering means better outcomes for customers, such as lower costs and better services without a requirement for a government mandate. As a result, it reduces the political risk to government.

ERAA's policy position — smart technology in the energy retail market

The ERAA and its members support the implementation of smart metering and consider that smart meters have an important role to play.[1] Some of the benefits that the ERAA and its members see in smart metering include:

- The ability to provide customers with more accurate and timely bills;
- Reducing customers' exposure to 'bill shock' by increasing customer billing cycles;
- Helping customers better manage and understand their energy consumption and costs; and
- Allowing customers to choose new and innovative products and services.

[1] Energy Retailers' Association of Australia 2012 Smart Technology in the Energy Market, Position Paper, January 2012, www.eraa.com.au

However, the ERAA believes that any decision of policy makers to support exclusive control of smart metering (for example, by distributors in Victoria) is inconsistent with the original principles of electricity reform and national competition policy and that this approach poses a significant risk to competition in energy retail markets.

Retailers are well-placed to deliver smart metering to customers, including residential and small business customers. Competition between retailers underpins the incentives that retailers have to roll out smart meters to their customers and to deliver the range of services and products that customer want at a price they are willing to pay. As it is delivered through a competitive market, a market-driven roll out of smart meters avoids the inherent difficulties and imperfections of network price regulation.

A market-driven rollout also ensures that the meter specifications are based on the smart metering services that customers want and provide the flexibility for retailers to develop new products and services for their customers. Distributor-led roll outs are typically focussed on the needs of the distributor and not necessarily about the enabling technology that delivers what the customer wants. Mandated distributor-led rollouts creates the potential for customer needs to be secondary to industry needs, alienating the customer, and making the customer feel as though they are paying for something they did not ask for (as has occurred in Victoria).

Drivers of a market-driven rollout

Competition and the ability to reduce operational costs and inefficiencies are the key incentives that retailers have to roll out smart meters to customers, including residential and small business customers. The potential to offer customers the benefits of smart meters can provide a retailer with a competitive advantage. A retailer that rolls out smart meters first can offer new and existing customers a range of energy information and management services. As a result of the first retailer's initiative, other retailers will be incentivised to offer the benefits of smart meters to new and existing customers to protect market share and also grow market share at the expense of retailers that are not so willing to innovate.

The other incentive that retailers have is that smart meters allow retailers to access significant internal operational efficiencies that can assist the internal business case on the rollout of smart meters. These efficiencies can include:

- Reduced exposure to wholesale and settlement risk as wholesale positions are more aligned to actual rather than net system load profiles;
- The automatic delivery of consumption data to retail operations allowing for more accurate reconciliation, settlement and billing capabilities;
- Better consumer analytics to assist in the development of new products;
- Lower meter reading costs as remote reads replace manual meter reads (including special reads);
- Lower disconnection/reconnection costs as remote de-energisation and re-energisation replace manual disconnections and reconnections;
- More accurate meter reads resulting in reduced back office costs;
- The potential to bill customers monthly and with actual rather than estimated meter reads reducing 'bill shock', bad debt write offs and associated ombudsman and customers complaints; and

- Assisting to reduce working capital requirements as cash flows improve as the time gap between when wholesale and network bills are settled and when customers' bills are paid is reduced.

The incentives that retailers have to roll out smart meters means that any roll out can be achieved without the need for regulatory or Government intervention. A market driven rollout will, by definition, occurs in response to consumers being ready and willing to have their meters upgraded in order to access better products. This means that the political risk to governments will be greatly reduced relative to larger scale mandated rollouts. Unlike a mandated roll out, as witnessed in Victoria, customer support for smart meters is shaped through the marketing of the smart meter services and the customer's explicit informed consent to a product choice that they see as reflecting benefit to themselves. If a product, or service, is forced upon a customer then the competitive nature of the market means that they will churn away to another provider. This is not possible in a distributor-led rollout where the distributor faces no risk of losing the customer.

Why retailers have not sought to undertake such rollouts in the past given the incentives that exist to do so

The barriers have been the regulation of manually read metering as a monopoly service provided by distributors and the bundling of metering charges in network charges.

At the inception of full retail contestability, regulating metering as a monopoly service was deemed to provide more efficient outcomes given the relative cost, volume and the local presence of distributors for small customers. However, exclusivity for the provision of metering services was originally introduced as a transitional measure to address issues of cost and complexity which would have arisen had competition for metering services been introduced simultaneously with full retail competition. It was anticipated at the time that exclusivity would expire at the end of the transitionary period because of the view that metering competition would facilitate innovation both in terms of the type of meter installed and the way in which meters were read.[2]

Despite most retail markets now being fully contestable, many jurisdictions have not acted to remove the artificial barriers that prevent retailers from providing small customers with competitive metering services. Jurisdictions have extended exclusivity provisions beyond the point where the retail market has become contestable and, most importantly, metering charges for manually read metering have remained bundled in network charges.[3]

The bundling of metering charges in network charges is a significant barrier to retailers rolling out competitive metering services, including smart metering. If a retailer had replaced a householder's manually read meter with a smart meter, the retailer would still need to pay the bundled network charge. In other words, the network charge would not be reduced as a result of the distributor's meter being removed from

[2] Essential Services Commission (Victoria), Essential Services Commission of South Australia, Independent Competition and Regulatory Commission (ACT), Independent Pricing and Regulatory Tribunal (NSW), Office of the Tasmanian Energy Regulator, Queensland Competition Authority, 2004 *Joint Jurisdictional Review of Metrology Procedures: Final Report*, p. 41

[3] It is worth noting that Essential Services Commission (Victoria) was the only state regulator to implement the recommendations of the *Joint Jurisdictional Review of Metrology Procedures* — that distributors should only have exclusivity for manually read metering and that metering charges be unbundled from network charges. However, the Victorian Government's decision to mandate a rollout of smart meters undermined the ESC's decision because retailers did not have time to take advantage of that decision before new regulatory barriers were created.

the premises and the retailer ends up paying for a service they no longer use. This materially impacts the business case retailers may have to rollout smart meters.

To address these regulatory failures, all remaining exclusivity provisions (including those in Victoria) must end and metering charges must be unbundled from network charges so that the cost of the existing meter can be identified and avoided if the customer chooses to take up a retailer's offer of smart metering services.[4]

How a market-driven rollout would work

To demonstrate how a market-driven smart meter rollout would work, we have set up some scenarios to show how smart meters can be managed in a competitive market.

In the scenarios, there is no government mandate to roll out smart meters — the decision to provide a householder with a smart meter is left to the competitive market to deliver through a market-driven rollout.[5]

Scenario 1: Suburban home without a smart meter

The *Householder* is a typical suburban residential customer who currently has a retail contract with *Retailer A*[6] for the supply of electricity. The home has a manually read meter with all appliances in and around the home being supplied through that meter.

To take advantage of the market-driven drivers set out above, *Retailer A* approves an internal business case to replace the *Householder's* manually read meter with a remotely read smart meter.[7] *Retailer A* engages with the following external providers:

- A *Meter Provider* to install the smart meter.
- A *Meter Data Provider* to manage the meter reading and deliver meter reads to the retailer, the LNSP and AEMO for settlement and billing purposes.

[4] One issue that policy makers will need to address in dealing with these regulatory failures is the imposition of exit fees by distributors for the removal of the existing meter. Exit fees should be aligned with the early termination fee principles established by the National Energy Consumer Framework where early termination fees can be no more than a reasonable estimate of costs resulting from early termination. In terms of early termination fees for metering assets, this should be no more that the depreciated value of the remaining life of the asset and not replacement cost as the distributor is not being required to replace the asset.

[5] This is the New Zealand model, comprising a retailer-led rollout within the context of a very highly competitive market.

[6] *Retailer A* is a fictitious Energy Retailer for the purpose of demonstrating the role and activities of a Retailer in this scenario

[7] For the purposes of these scenarios, the ERAA has assumed that it is the retailer that makes the decision that there is a benefit that can be obtained from rolling out smart meters. However, the market participant that takes this decision could also be a distributor, a meter provider or a third party service provider. For example, a distributor may wish to initiate a rollout of smart meters in its territory. The difference with a market-driven rollout is that the distributor would approach retailers in its area to manage and coordinate the rollout. This would include if a distributor wishes to replace an ageing accumulation meter with a smart meter — a distributor would need to engage with the retailer as the Responsible Person for the site to organise for this happen so that competition and innovation in smart metering is maintained.

The contract that *Retailer A* establishes with the *Meter Provider* and the *Meter Data Provider* requires the following:

- Both the *Meter Provider* and the *Meter Data Provider* retain accreditation with AEMO throughout the life of their contracts;
- The installed metering infrastructure and meter readings meet all technical and service level requirements in accordance with the National Electricity Rules (NER); and
- The *Meter Provider* and *Meter Data Provider* comply with any extra conditions that may be stipulated in their commercial contracts with *Retailer A*.

The *Meter Provider* carries out the meter change, allowing the *Meter Data Provider* commencement of remote meter reading and services as agreed under the commercial contract with *Retailer A*.

In this scenario, the *Householder* is still on their existing market contract with *Retailer A*, paying the same flat rate or two part tariff that they were paying prior to the meter change. However, the *Householder* benefits from additional services such as a sharp reduction in estimated reads (a primary driver of customer dissatisfaction), more timely billing and remote re-energisation and de-energisation, or perhaps the choice of an alternative flexible tariff facilitated by the new metering.

How has the meter change been paid for?

The costs to *Retailer A* of contracting with the *Meter Provider* to install the meter and the *Meter Data Provider* to read the meter will be offset to some extent (maybe even fully offset) by lower network charges that exclude distributor-provided metering and by the operational efficiencies from having the smart meter in place (as set out above in *Drivers of a market-driven rollout*). *Retailer A* may also factor in the additional earnings that it could make by selling the customer additional smart metering services.[8]

In rolling out a smart meter to the *Householder*, *Retailer A* will also naturally consider the competitive response of its rivals and the response of its customers. *Retailer A* will seek to provide the meter at least cost to the *Householder*. It would help the retailer's customer retention if a meter were provided without increasing costs to its customers. The driver — the need to maximise customer value or risk losing customers — is a key differentiator between a contestable retail market and the provision by a monopoly distributor

- *Retailer A's* decision to provide the *Householder* with a smart meter and the potential for the new smart meter services it can offer the *Householder* may pose a potential competitive threat to other retailers who may decide to undertake similar roll outs to their own customers, or start to offer new services that compete with *Retailer A* using the new smart meter. *Retailer A* will seek to undertake its roll out at least cost to the *Householder* as a protection against new competitive entry into the smart metering services market.
- Alternatively, *Retailer A* may have overstated its business case for smart meters and the *Householder* may not be as attracted to smart metering services as *Retailer A* anticipated. If *Retailer A* increases prices to the Householder to recover the cost of the smart meter but cannot retain the *Householder* through the sale of associated services, then there is a very high likelihood that *Retailer A* will lose that customer to another retailer.

[8] In developing a business case, a retailer will market test customers' willingness to pay for any new services and products the retailer may be able to offer, inclusive of any distributor benefits that the retailer may negotiate with the relevant distributor. If there is a positive willingness to pay, then this will assist the retailer in generating a positive business case for changing the metering arrangements in a premise.

The *Householder's* willingness to pay for smart metering services and the reactions of its competitors drives *Retailer A* to find the means to pay for the roll out while trying to minimise any cost increases for customers.

In summary, internal operational efficiencies combined with external competitive pressure are the drivers for retailers to minimise the costs of deploying smart meters. At the same time, the customer is better off because there are significant benefits available to the customer. For example, *Retailer A*, as a result of the smart meter deployment, can now routinely bill the householder on a monthly basis, and always with actual data – thus assisting the *Householder* with cash flow management, and greatly reducing the incidence and severity of "bill shock". Given that the *Householder* was previously only billed on a quarterly basis, and sometimes on estimated data, this could be a significant enhancement to their customer experience.

How does the customer get access to the additional services provided by smart metering?

With the smart meter in place, *Retailer A* has an incentive and the ability to offer the *Householder* a range of new services and products enabled by the smart meter. These new services and products could include In Home Displays, smart-phone or tablet apps, web portals, demand management and a range of other services that assist the *Householder* manage their energy bill.

To obtain these new services, the *Householder* consents to enter into a new market contract with *Retailer A* for the delivery of energy and access to a range of new services and products after having considered the optimal mix of services they want and the price they are prepared to pay for those additional services. Of course, the *Householder* may elect to purchase no additional services over and above their basic energy contract – the challenge for *Retailer A*, as with any retailer in any competitive market, is to develop a product and service offering that its customers will be willing to pay for.

Scenario 2: Suburban home with a smart meter but customer switches retailer

This scenario builds on Scenario 1 by having the *Householder* deciding to change retailer, some time after the initial retailer (*Retailer A*) has already provided a smart meter to the *Householder*. The assumptions in this scenario are as follows:

- There is no government mandate for a rollout of smart meters.
- As a result of Scenario 1, the *Householder* now has a smart meter on the house. The meter is owned by the existing *Meter Provider* and the services from the meter are provided by the *Meter Data Provider* to *Retailer A*. These arrangements are based on a contractual arrangement between these two parties.
- The *Householder* has a market contract with *Retailer A* for the supply of energy and perhaps a range of additional services that they have consented to through the use of the functionality provided from their smart meter (such as access to a web portal and some use of load control services).

After some time (perhaps a year) on the new market contract with *Retailer A*, the *Householder* decides that *Retailer B* is offering a better deal and exercises their right to switch retailers. At this point, one of the customer benefits of the smart meter becomes apparent — the smart meter with its remote and on-demand reading capability enables the transfer between retailers to take place very quickly. This is because the final read before the transfer occurs can be performed at any time: there is no need to arrange (and pay) for a special on-site read or for the customer to wait for the next scheduled manual read date.

Further, in this scenario, the existing smart meter at the property supports all the services that *Retailer B* has to offer and thus there is no need to churn the meter.

How does the market manage this situation?

To manage the metering arrangements at the *Householder's* premises, *Retailer B* establishes its own contract with the existing *Meter Provider* to retain the smart meter provided by the existing *Meter Provider*. Again, this contract will require the *Meter Provider* to comply with the requirements in the Rules and to meet all relevant technical and service level specifications. (Note that *Retailer B* may already have a contract with the existing *Meter Provider* for the service of other premises and thus no new contract need be established. Instead, the existing *Meter Provider* is providing and managing the meter on behalf of *Retailer B* rather than *Retailer A*). *Retailer B* thus takes on the cost of metering at the property from *Retailer A* so that, in effect, the meter and meter services contract has shifted from *Retailer A* to *Retailer B*.

Retailer B has an incentive **not** to replace a technically functioning meter already installed at the house, because *Retailer B* would incur additional costs from doing so.

- Passing this cost on to the *Householder*, with the associated inconvenience of a technically unnecessary meter change, would make *Retailer B's* offer to the *Householder* less attractive and the *Householder* may naturally decide to stay with *Retailer A*.
- Even if *Retailer B* could absorb the costs of installing another meter, it would not make good business practice to do so because the existing meter already has the functionality that the *Householder* wants to use. It is cheaper for *Retailer B* to enter into a contract with the existing *Meter Provider* rather than replace the meter.

In 2005, the Australian Competition and Consumer Commission (ACCC) recognised that concerns that retailers would need to churn meters as customers churned were overstated:

> *The ACCC considers that concerns that meters will be removed in circumstances where it is inefficient to do so may be overstated, and that avoiding metering churn is not of itself sufficient reason to continue the metering derogations. The ACCC further considers that such concerns assume that retailers will tend to replace meters, irrespective of whether this is a commercially beneficial decision. It is likely that a rational retailer (that does not wish to create barriers to switching) will only choose to replace meters when it is efficient to do so. … The ACCC considers that meter churn can also be a by-product of the adoption of innovative forms of metering and tariffs.*[9]

Scenario 3: Suburban home with a smart meter but customer switches retailer and churns meter

In this scenario, after a year with *Retailer B*, the *Householder* decides to switch retailers again. This time, the *Householder* wants to contract with *Retailer C* who has demonstrated to the *Householder* that it has a range of new products and services that *Retailer A* and *Retailer B* cannot provide, perhaps due to the technical limitations of the existing meter. *Retailer C* is seeking to gain a competitive advantage over *Retailer A* and *B* by innovating and developing new products and services that it believes will be of value to the customer and the customer will be willing to pay for.

However, to access these new services, *Retailer C* must replace the existing smart meter with a meter that supports the new services being offered.[10] This requires *Retailer C* to engage with an accredited Meter

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[9] Australian Competition and Consumer Commission 2005 *Applications for Authorisation: Amendments to the National Electricity Code*, Victorian Metering Derogations, P. 26

[10] The ability to replace the meter for new services requested by consumers is important for innovation as customers move from a spectrum of being "uninformed" to "informed". Restricting flexibility in meter replacement will impede the market and constrain product and services development enabled by smart meter technology."

Provider that supports the new services the *Householder* wants. This could be the existing *Meter Provider* or another Meter Provider.

How does the market manage this?

- Now that Retailer B has lost the Householder, the contract with the existing Meter Provider will no longer apply. The existing Meter Provider does not lose any value from a stranded asset because meter providers incorporate the risk of stranding into the original prices that it agreed with Retailer B. It is also possible that Meter Provider may be able to re-use the asset in another premise, (e.g. another retailer may have won a new customer in a new housing estate and thus contracted with the Meter Provider to install the smart meter into the new customer's house).
- The cost of the new meter from Retailer C would be incorporated into the market contract to which the Householder would need to give explicit informed consent to enter into. Thus, the Householder must either be willing to pay for the additional functionality built into the new meter, or Retailer C must absorb these costs. If neither of these conditions holds, then the Householder has the option of remaining with Retailer B receiving the smart meter services the Householder was previously receiving (or indeed switch to a different retailer entirely). In this case, Retailer C will need to re-consider its proposition and business model because the market is telling Retailer C that customers are not willing to pay for its product – this is the reality of a competitive retail market.
- The cost of Retailer C's new meter would reflect the Meter Provider's view of the life of that meter. Thus the additional charge the Householder would pay would be an annualised cost of the meter. The Meter Provider would be likely to approach other retailers and market participants to promote its new meter, reduce the risk of it becoming stranded and improving its pricing and helping increase the take up of Retailer C's new offer requiring the meter. It is also possible that Retailer C may absorb at least some of this cost in order to acquire the new customer and make their product more appealing in the market place. This is a marketing and pricing decision for Retailer C.

What happens if the Householder decides it no longer wants the additional services provided by Retailer C and wants to switch back to the product it was previously on with Retailer B?

In this scenario, it would again make no economic sense for *Retailer B* to want to churn the meter unnecessarily.[11] The sophisticated metering that is at the premises is more than capable of delivering the services that customer now wants. Thus, as with scenario 2, *Retailer B* will contract with the relevant meter provider and meter data provider to meet its meter provision and data reading responsibilities under the Rules.

[11] The market could also accommodate a situation where the customer did not want to continue paying the annualised amortised cost of the smarter meter installed by *Retailer C* when the *Householder* switched back to *Retailer B*. *Retailer B* could organise with its *Meter Provider* to replace the smarter meter with the smart meter that was previously at the property. Thus, the customer would likely pay a lower amortised cost for the meter reflecting the lower technical capability of the metering device. However, as discussed later in this paper, the ERAA proposes that retailers agree to a no-reversion policy where this makes economic sense.

Scenario 4: Suburban home with a smart meter and services provided by a third party supplier

In this Scenario, the *Householder* has a market contract with *Retailer C* but has heard about the services offered by *Electric Vehicles*. *Electric Vehicles* is able to offer the *Householder* an electrical vehicle product and associated services. The *Householder* has a smart meter and enters into a contract for the services supplied by *Electric Vehicles*.

It is important to note that there is no need for any over-engineered 'solutions' to the metering arrangements at the house — there is no need for a second meter, a child meter or second NMI at the premises. As a result, the costs to the *Householder* of obtaining services from third parties such as *Electric Vehicles* is lower than if new or additional metering arrangements were put in place. This in turn can widen the appeal of these sorts of services to the customers.

How does the market manage this situation?

- As *Retailer C* is still supplying energy and smart metering services to the Householder, the contract between *Retailer C* and the *Householder* still applies
- The contract between *Retailer C* and the existing *Meter Provider* still applies
- The multiple registers contained in *Retailer C's* smart meter already installed at the premises allow different loads to be measured separately and billed separately:[12]
    - Register 1 is used to measure the general load the *Householder* uses and is billed by *Retailer C*.
    - Register 2 is used to measure the load going to the electric vehicle and is billed by *Electric Vehicles*.

  Thus the *Householder* receives two bills — one from *Retailer C* and one from *Electric Vehicles*.
- *Electric Vehicles* establishes a meter services contract with the *Meter Data Provider* for the site to deliver reads for settlement and billing purposes

This scenario can be applied in many ways. For example, the customer could have a contract for energy supply *and* a contract for electric vehicles with *Retailer C*. What is important in this scenario is that the smart metering technology is not a barrier. In fact, the smart meter is an enabler of new products and services and lifestyle choices for the *Householder*.

However, there is a requirement to develop a third party framework to ensure that there are sufficient customer protection arrangements in place to protect customers in their dealings with third party service suppliers. This could include some form of licensing/authorisation of these third party suppliers to ensure that there is adequate enforcement arrangements of the obligations to customers that these suppliers have, just as there are for electricity retailers.

Appropriate arrangements may also be required to ensure the financial integrity of the electricity market and that the operations of third parties do not undermine the financial resilience of the market.

[12] A minor change to network billing arrangements will be required to accommodate multiple registers in the meter.

Examples of market-driven rollouts of smart meters

There are examples of successful market-driven roll outs of smart meters, such as New Zealand where a market-driven roll out of smart meters to smaller customers, including residential and small business, has occurred.

In New Zealand, Meridian (the largest retailer in the South Island) took the lead in rolling out smart meters to its retail customers in the Canterbury area. Meridian's business case was based on achieving the savings from unaccounted for energy loss, manual meter read, meter leasing, automated disconnection/ reconnection, reduced back office labour, reduced call centre volume from fewer errors and reduced non-technical losses. These savings equated to the costs of the new smart metering installation.[13]

In response to Meridian's initiative, other retailers have also commenced rolling out smart meters.

Rather than mandating a roll out, the Electricity Authority of New Zealand has focussed on ensuring that there is open and non-discriminatory third party access to metering services so that there are no barriers to competition whilst attempting to preserve the conditions for innovation among meter providers and retailers.[14]

There were initial implementation issues in NZ's market-driven rollout, primarily due to retailers rolling out meters before an appropriate supportive regulatory framework was in place. NZ found that, as has occurred under government mandates for a distributor-led rollout of smart meters in Australia, it is important that an appropriate legislative and regulatory framework is in place to support a market-driven rollout of smart meters.

Further information on New Zealand is found in Box 1.

Box 1: Smart metering in New Zealand

1. The New Zealand Authority determined in 2012 that the metering services market in NZ is "workably competitive", with multiple retailers, distributors and other parties obtaining metering services from competing metering owners/operators.
2. Regulatory intervention would likely hamper the efficient development and operation of the metering services market by diminishing the commercial and competitive incentives for efficient provision and procurement of metering data and services.
3. Commercial negotiations currently represent the most efficient approach for participants in the metering services market to obtain access to metering data and services for the long-term benefit of consumers.
4. Advanced Metering Services (AMS), owned by Vector, is the largest metering service provider in New Zealand, with about 42 per cent of accumulation and advanced meters. AMS is supplying 500,000 advanced meters for Genesis Energy, with about 250,000 advanced meters installed under that contract to date.
5. Meridian Energy, Mercury Energy, Trustpower and Contact obtain metering services in-house, from their own subsidiary Metering Equipment Provider (MEP) or from other MEPs. Contact agreed in late 2011 to use AMS to supply some metering services, and AMS is to deploy about 150,000 advanced meters for Contact in the North Island by 2014, starting in May 2012.
6. The Authority considers that a workably competitive market can involve duplication. MEPs that have made a poor technology choice or are unwilling to continue investing in a metering fleet should not be protected by regulation from being duplicated or displaced.

[13] VaasaETT and EEE 2010 Country Reports: New Zealand

[14] *ibid*

7. The key requirement (or barrier) for entry by a firm wanting to be an MEP or to access metering data appears to be obtaining the agreement of the consumer to install metering equipment (without interfering with other metering equipment).
8. Retailers have a clear interest in maintaining a competitive metering services market because retailers rely on MEPs to provide a good service so as to deliver the range and quality of service expected by their customers. Consequently, retailers have commercial incentives to make strategic procurement decisions so that they retain a choice of service provider. If service levels aren't maintained than an alternative MEP can be sourced. This decision relies on there being an alternative MEP able to offer the desired service at a price the purchaser is willing to pay.

Reference: http://www.ea.govt.nz

Facilitating a market-driven smart meter roll out

As noted, a market-driven rollout of smart metering requires an appropriate regulatory framework is in place to support that rollout. A number of factors need review including:

- The unbundling of metering charges from network charges so that retailers and customers are not required to pay twice for metering services;
- The discontinuation of any legislative barriers, such as metering derogations, that give distributors exclusivity over the metering arrangements for certain customer types;
- A no-reversion policy must be established which could be an industry agreement that metering installed at a premise is not removed in favour of less technically capable metering;
- Appropriate ring-fencing arrangements around participants in the market (distributors-retailers-meter providers) so that cross-subsidisation between participants does not undermine the competitive market;
- Open access arrangements that allow multiple parties to concurrently offer services across a single party's metering infrastructure;
- Appropriate B2B arrangements to facilitate the new metering arrangements; and
- Customer protection arrangements that support customer switching in a competitive metering market and their engagement with third party service providers.

The ERAA supports the view that the existing type 4 metering framework and metrology provide a sound foundation to support a market-driven smart meter rollout. This framework provides a minimum functionality specification and outlines the minimum service levels that the smart meters would need to meet.

About the Energy Retailers' Association of Australia

The ERAA is the peak industry body which represents the core of Australia's energy retail organisations. Membership is comprised of businesses operating in the electricity and gas markets in most Australian states and territories. Collectively, our members provide electricity to more than 98 per cent of customers in the national energy markets and are the first point of contact for customers of both electricity and gas.

Competitive neutrality in energy service provision

ERAA smart meter Working Paper 3

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Competitive neutrality in energy service provision

Energy Retailers Association of Australia (ERAA) smart meter Working Paper 3

There are currently several types of business seeking to engage with consumers about smart meters and their benefits: distributors, retailers and third parties. The principle of competitive neutrality means that these service providers compete on a level playing field, where no party is able to take advantage of different or business-specific regulatory requirements. For example, distribution businesses are funded by regulated revenue and so have a natural competitive advantage. The concept of competitive neutrality demands that these parties separate what are considered contestable, market services from those that are rendered in monopoly markets. This is called 'ring-fencing', and it has been a core aspect of energy market reform as jurisdictional retail markets have opened.

The original energy market reform across the jurisdictions was carried out under the auspices of National Competition Policy, which embedded these notions of competitive neutrality and ring-fencing. However, recent industry changes seem to have neglected the principles of competitive neutrality and ring-fencing: a number of distribution businesses have argued that the paradigm change of smart meters and smart grids requires a more fluid industry position, and importantly, one that sees a reduced need for competitive neutrality and ring-fencing.

This paper explores the current debates around competitive neutrality and ring-fencing, arguing that decisions on the role of smart meter and smart grids technology that compromise these important principles compromise the long term objectives of National Competition Policy in their effect, which ultimately results in reduced market efficiencies and higher costs for consumers.

Policy objectives for service provision enabled by smart meters

The introduction of smart meters into Australian jurisdictional energy markets must be consistent with the framework and agreements of National Competition Policy, including structural separation of natural monopolies and contestable activities, competitive neutrality and access arrangements to the regulated monopoly infrastructure. The fundamental rationale of energy market reform was that it would maximise consumer benefits in the form of efficient prices, increase choice and enhanced quality of services. This rationale has not changed with the introduction of smart meter technologies.

This means that there should always be a level playing field for providers of energy services. It will not be beneficial to consumers to grant rights to monopoly service providers that are not extended to retail competitors. It is also not reasonable to require higher service standards from some service providers and not others providing the same services.

The current state of play

The current policy approaches to mandated smart meter implementation are not based on a cogent third party access model. This is likely to be a reflection of the fact that the policy debate has become captured by the notion that smart metering and smart grids are ends in themselves, rather than simply a means to deliver consumer benefits. The narrow focus on the role of new technology has provided the foundation for some market participants to suggest that competitive neutrality is no longer relevant, and that the roles of market participants should be changed. For example, the role of the distributors in Victoria to implement smart metering has created an impediment to market innovation, as retailers and third parties are not able to compete with distributors on a level playing field. This negatively affects the risk perceptions of parties seeking to enter the market, and may warrant the departure of some market participants. This is clearly not in the interests of consumers, nor would this pass the net public benefit test for costs involved in any smart meter infrastructure programme.

The alternative to this approach is to refresh market participants' understanding of competitive neutrality and ring-fencing, and to actively support regulators in this area. Ring-fencing is even more important in the current environment if we are to capture the benefits of the market and share these with consumers. Where distributors manage consumer meters for the market (through their contracts with meter providers), it is vital that the distributors provide access to the meter and meter data to ensure that consumers continue to benefit from competition. As discussed in *Working Paper 2*, ERAA believes that any smart meter rollout should be market-led, which means that no party will have a monopoly and the provision of all metering services are contestable.

Competitive neutrality should also underpin the provision of services via smart meters. A number of parties – including some distributors – have suggested that many smart metering services could be provided by a range of different entities without further regulatory intervention, which means that parties would be competing on unequal terms. The key services discussed are those that make use of a consumer's personal meter data to customise home management products and perhaps even turn off appliances (direct load control) as per a contract with the consumer. This is not a good outcome for customers if distributors undermine competition by funding the delivery of smart metering services through their guaranteed regulated revenue stream. It will result in reduced competition, reduced customer choice over the smart metering services they have available to them and thus lower consumer benefit.

The products and services that can be delivered through smart metering technology do not possess characteristics that would define them as monopoly products and services, such as declining economies of scale. The contestability of smart metering services and products has been recognised by the ACCC and NER.[1]

[1] See page 85 of Accenture (2011) *IHD Inclusion into ESI scheme: Final Report*, for Department of Primary Industries, Victoria, December.

ERAA position

The ERAA considers that new technology should not be regarded as an end in itself and should not be used to alter the principles of energy reform and National Competition Policy which underpin the National Electricity Market. It is important to maintain the principles of separating natural monopoly and contestable components, competitive neutrality in pricing, and third party access to meters.

Regarding products and services to consumers, retailers should be the conduit for service provision, where this includes parties authorised to sell energy services as discussed in *Working Paper 5*. This means that distributors can also participate, but only where they are appropriately ring-fenced and are competing on equal grounds. Under the current market structure, retailers have built long term relationships with their customers, which translates in retailers' ability to develop products and services that meet consumer needs.

The public benefit test as outlined in National Competition Policy should be applied as part of any consideration of mandates or other exclusive arrangements applied by governments that restrict or potentially restrict competition. Any smart metering services provided by an entity related to a distribution monopoly business must be structurally and operationally separated from the regulated "poles and wires" business. This will ensure the distribution business does not gain any commercial, functional and informational advantages over other independent smart metering businesses.

While the ERAA does not dispute that demand side participation could help alleviate rising network costs and assist distributors better utilise their assets, the ERAA questions recent policy discussions that have supported distributors developing a direct relationship with customers to deliver demand side programmes in the contestable market. In principle, the ERAA considers that distributors should be able to shed or control consumer load in the case of emergency or safety requirement. However, where distributors seek to provide non-emergency load control and other forms of demand side participation to relieve the need for network augmentation for peak load (outside the applicable regulatory mechanisms) distributors should first go to the market and engage with authorised parties to deliver mass market demand side response programmes. If the market cannot deliver the desired outcome it is fair to then provide for a distributor to manage its risk as required, which may include it embarking on its own demand side management programme within the existing regulatory framework. However, it is appropriate to ask whether this is the best and most efficient approach.

Further, there needs to be strong enforcement regime, including regulatory incentives and penalties for any breaches of ring-fencing regulations. The recent AER review (December 2011) on the need for a nationally consistent ring-fencing guidelines is necessary and was welcomed by ERAA. It is also necessary for Australian Energy Market Commission to review and clarify the application of ring-fencing rules to the provision of smart metering services and examine the efficacy of the rules for emerging markets.

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Privacy of personal information: how to ensure appropriate use and disclosure of smart meter data

ERAA smart meter Working Paper 4

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Privacy of personal information: how to ensure appropriate use and disclosure of smart meter data

Energy Retailers Association of Australia (ERAA) smart meter Working Paper 4

Conventional electricity accumulation meters are usually read every three months, providing a consumer's retailer with one value for the previous 90 days' electricity consumption, which is generally charged on a flat rate. Remotely read interval meters (smart meters) change the availability of electricity consumption data from one value per 90 days to closer to 4,320 values in 90 days, as the meter stores the consumer's consumption data per half-hour. This is obviously a significant increase in the volume and granularity of data about consumer energy use.

Concerns have been raised in the community about a potential risk for smart meter data to be misused, intercepted or provided to third parties without the appropriate consent of the customer. For example, fears have been expressed that unauthorised parties could intercept information from outside the wireless network, or that privacy and home security could be jeopardised by unauthorised entities knowing a family is away by the household's energy pattern.

A privacy impact assessment carried out for the Victorian Government about the Victorian smart meter programme has shown that many of these concerns are unfounded. The consultants' report found that:

> *Technically, privacy controls are relatively strong…Metering data is suitably protected in transit and at rest, and is subject to [regulatory] confidentiality provisions …The industry has adopted good information security standards and practices. The security of smart meters themselves is well designed; in particular, the wireless communications links between meters and Distribution Businesses, and between meters and Home Area Networks, appear very sound. All wireless links are encrypted, and unlike domestic wifi networks which have proven problematic for drive-by snooping, smart meter encryption cannot be disabled. There are also strong security governance practices; it is not currently possible for third parties to obtain metering data without being licensed participants, or without having commercial arrangements with e.g. a Retail Business.*[1]

However, deeper privacy impacts are still possible, such as unauthorised use by third parties or use or disclosure by any party that goes beyond the spirit of the National Privacy Principles (NPPs).

The security of consumers' personal information is a core concern for retailers, and all existing retailers prioritise compliance with the NPPs. From a retailer perspective the real privacy concerns arise where governments expect meter data to be uploaded to third party sites without the consumer's express consent required by the NPPs, or where smaller third parties are currently exempt from the NPPs because of size. This paper explores these issues.

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[1] Lockstep Consulting (2011), *PIA Report: Advanced Metering Infrastructure (AMI)*, for the Victorian Department of Primary Industries, Version 1.2, August: p. 51.

Smart meter and privacy policy objectives

The primary objective for retail energy policy in general, and smart meter policy in particular, is to have cost-effective consumer outcomes which grant consumers choice of product and service provider but also do not force these choices on an unwilling or as-yet-unready consumer population. It is particularly important that relationships between service providers are seen as seamless and consistent and do not require significant further investment from a customer when they change their basic product and service preferences. Consumer access to privacy protections should also be consistent and should apply to all providers of energy services equally. Similarly, policy objectives should require a level playing field for providers of energy services.

On the privacy front, the NPPs require businesses that manage consumers' personal information to ensure that the appropriate measures are taken to ensure that collection, use and disclosure of personal information only occur according to a customer's reasonable expectations, and where a customer cannot be expected to assume secondary use or disclosure (or in exceptional circumstances), the business must obtain the customer's consent. The NPPs cover the following:

Collection (NPP 1): Describes what an organisation should do when collecting personal information, including what they can collect, collecting from third parties and, generally, what they should tell individuals about the collection.

Use and disclosure (NPP 2): Outlines how organisations may use and disclose individuals' personal information. If certain conditions are met, an organisation does not always need an individual's consent to use and disclose personal information. There are rules about direct marketing.

Information quality and security (NPPs 3 and 4): An organisation must take steps to ensure the personal information it holds is accurate and up-to-date, and is kept secure from unauthorised use or access.

Openness (NPP 5): An organisation must have a policy on how it manages personal information, and make it available to anyone who asks for it.

Access and correction (NPP 6): Gives individuals a general right of access to their personal information, and the right to have that information corrected if it is inaccurate, incomplete or out-of-date.

Identifiers (NPP 7): Generally prevents an organisation from adopting an Australian Government identifier for an individual (e.g. Medicare numbers) as its own.

Anonymity (NPP 8): Where possible, organisations must give individuals the opportunity to do business with them without the individual having to identify themselves.

Transborder data flows (NPP 9): Outlines how organisations should protect personal information that they transfer outside Australia.

Sensitive information (NPP 10): Sensitive information includes information such as health, racial or ethnic background, or criminal record. Higher standards apply to the handling of sensitive information.[2]

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[2] See http://www.privacy.gov.au/materials/types/infosheets/view/6583#npp1. The NPPs are also consistent with best practice worldwide, such as the United States Department of Homeland Security's Fair Information Practice Principles about its own dealing with personally identifiable information, which are used as a model throughout the United States and worldwide for smart meter programmes.
See http://www.dhs.gov/xlibrary/assets/privacy/privacy_policyguide_2008-01.pdf and Mulligan, D. K. and L. Wang (2011) *Final project report, Privacy in the smart grid: an information flow analysis,* Prepared for CIEE By: University of California, March, http://uc-ciee.org/downloads/Privacy_in_Smart_Grid_Final_Report.pdf.

The ERAA supports the view that the legal definition of "Personal Information" under the *Privacy Act* 1988 (Cth) can, and should be, interpreted to cover raw metering data. The definition of personal information is 'information or an opinion (including information or an opinion forming part of a database), whether true or not, and whether recorded in a material form or not, about an individual whose identity is apparent, or can reasonably be ascertained, from the information or opinion'. This means that energy service providers that collect, use or disclose consumers' meter data should be obliged to adhere to the NPPs, and the NPP legal principles need to be understood and embedded from a policy perspective.

The current state of play

Energy retailers are currently provided with meter data to bill consumers for their use, where accuracy and security of information is of vital importance to both the retailer and the customer. Retailers are the only parties to have consumer name, address, billing and payment data, and functions to support billing, collections, concessions and other functions are all protected through strict customer service procedures and training regimes. Retailers are also subject to regulatory audits to ensure that the information is secured from misuse and only accessible to authorised parties. The industry mechanisms for the transfer of data between market participants are also conducted in such a manner that ensures anonymity: consumer information is not transferred on a regular basis and is not transferred in conjunction with any other information. There are circumstances in which information is required to be communicated to ensure market stability is maintained in the event of a retailer going into administration, but this is conducted in accordance with the existing national energy rules which ensure that consumers remain protected during the transition.

This being said, the significant increase in data received by retailers when a customer changes to a smart meter brings with it new challenges for maintaining and securing data. Retailers have been working on their systems to accommodate this increase in data and are confident that compliance with the NPPs will not be compromised by retailer actions. The complication for the industry is more that smart meter technology has brought with it new government and consumer expectations of how consumer data can and should be used, and these expectations may not always align with the NPPs.

For example, the federal government is currently considering mandating a consumer data repository (the "iHub") that requires retailers to upload all small consumer meter data in order to provide access for consumers and for third party service providers who will use the data for a range of purposes. ERAA members are concerned that this policy initiative is not consistent with the NPPs, and that retailers - as the licensed or authorised custodians of the consumer data - will be held liable by consumers if data is used or disclosed without consent.

A further, and related, retailer concern is that retailers will be expected to disclose meter data information to parties who are not currently covered by the NPPs at all. The current *Privacy Act* 1998 (Cth) exempts businesses with an annual turnover of less than $3 million, which means that there could be a range of parties seeking to use or disclose consumer information who will have access but not be held to the same standard as existing industry participants. This is likely to be of concern to the community as well, and it can be expected that privacy concerns will escalate as consumers become more knowledgeable about the capacity of smart meters and associated technologies and products.

ERAA position

The use of technology to better manage the national energy market should not be at the expense of protecting customer data and information. Failures in relation to managing customer privacy will undermine consumer confidence in new technology, dampening the use of smart meter enabled devices and products and thus limit consumer benefit.

Consumers have a right to expect that their personal information will be treated according to the *Privacy Act* 1998 (Cth), where personal information cannot be used or disclosed for a secondary purpose without the consumer's consent. The ERAA believes that all businesses handling consumer meter data should be subject to the NPPs, regardless of size, and this must be provided for by relevant governments.

The ERAA also believes that initiatives such as the iHub should be compliant with the NPPs, requiring each consumer to provide their express consent to their retailer for the retailer disclose this information.

It has been shown that consumer concern about privacy issues increases significantly as their knowledge of smart meter rollouts and products increases,[3] which means that industry and government should be attentive and ensure that appropriate policy settings and industry practices are in place before any significant steps are taken to roll out smart meters. It will be important to educate consumers about smart meters and the privacy protections early in any communications campaign, and to then maintain messages and access to information about privacy as a permanent feature of a smart meter programme.

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[3] IBM, (2011) *The Future in Delivering Energy to the "Smart" Consumer*, Andrew Weekes, at http://public.dhe.ibm.com/common/ssi/ecm/en/euw03046usen/EUW03046USEN.PDF

Third party and distributor sale of energy management services

ERAA smart meter Working Paper 5

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Third party and distributor sale of energy management services

Energy Retailers Association of Australia (ERAA) smart meter Working Paper 5

Smart meters and associated technologies have opened up perceived opportunities to businesses seeking to enter the household energy market, and as a result, several recent policy consultations and discussions have touched on the role of third parties in the provision of energy services to small customers. It is positive that these discussions are occurring; however they appear to be based on particular products or service provider business models rather than appropriate principles for a new energy service approach. The policy discussions thus continue in an inefficient and piecemeal fashion. This has led to significant uncertainty, to the point where even previously understood concepts such as the separation of retailer and distribution businesses have become contested.

The ERAA does not oppose the presence of third parties in the retail space; rather the problem is that third parties are by definition outside the traditional service agreement between retailers and customers, and so there is no way to capture their service offerings consistently. The service offerings are also part of a new service paradigm that the current regulatory framework did not explicitly contemplate.

How do we conceptualise third parties and distributors entering the competitive home energy market and how do we provide for a competitively neutral environment and a consistent and fair consumer experience? This paper explores these issues, arguing that all participants selling certain energy services in the competitive market should adhere to the same consumer protection regime and distributors selling these services should be appropriately ring-fenced from their regulated network businesses.

Policy objectives for service provision enabled by smart meters

The primary objective for retail energy policy in general, and smart meter policy in particular, is to have cost-effective consumer outcomes which grant consumers choice of product and service provider but also do not force these choices on an unwilling or as-yet-unready consumer population. Smart meters and associated products should be seen as enabling consumer choice of time-sensitive energy products and services (an unmet market), and providing opportunities to engage with the market.

It is particularly important that relationships between service providers are seen as seamless and consistent and do not require significant further investment from a customer when they change their basic product and service preferences. Customer access to consumer protections should also be consistent, which means that for certain energy services all service providers have similar, if not the same, obligations.

Similarly, policy objectives should require a level playing field for providers of energy services. It will not be beneficial to consumers to grant rights to monopoly service providers that are not extended to retail competitors, and nor it is reasonable to require higher service standards and stronger obligations from some service providers and not from others providing the same services.

The current state of play

Without changes to the existing consumer protection frameworks to account for third party activities, third parties will be entering consumer premises to retail energy services with no specific minimum standards of behaviour other than the Australian Consumer Law. Some may argue that this is appropriate, but it is worth considering the products on offer – these are products that can result in disconnection of supply, billing complexity and marketing contracts for changes to an essential service. These are the elements of energy supply that created the need for a comprehensive consumer protection framework for retail energy to date.

Policy debates to date have often characterised the new opportunities that come from smart technologies (and electric vehicles) as potentially requiring market rule changes to allow for competition at every level. Minimum standards, licensing or authorisation have been subsumed as secondary matters, if they are raised at all. There has been some effort to fit the new players and new products into the established retailer-customer contract: some parties have argued that third parties in the competitive market should be seen as agents of the retailer or customer (or customers themselves). Third parties may represent themselves as agents of consumers to access customer data, or they may consider themselves as the customer in a market sense and then on-sell to end users.

However, stretching existing definitions to fit new entities is problematic: definitions are fluid and the entity that is the agent of the customer today may tomorrow offer energy retail products in direct competition with licensed/authorised energy retailers. On-selling could mean that consumers are not covered by consumer protections unless licensing/authorisation frameworks and exemptions regimes explicitly cover the service provision in question. We have seen the above already suggested in the market to date and no doubt there are many other possibilities. The problem is that this lack of clarity risks undermining the credibility of the consumer protection framework, as consumers will find that they have no recourse against their 'agents' when things go wrong and they will find that their retailers cannot solve third party problems. It also jeopardises competitive neutrality between service providers, given that retailers already exist and are obliged to comply with a range of customer service standards in the competitive retail market.

If the consumer protection regime is not made consistent across all providers of certain energy services we can anticipate significant consumer confusion, particularly as third parties will have different and complex business models and no consistency in how they bill or communicate with the consumer. The methods that these entities use to recover debt, to manage insolvency and to address complaints will similarly be left open. As uptake of third party energy services increases, the costs of managing this environment will be felt by existing market participants who will be referred to when there are problems, and by regulatory, policy and political staff across the jurisdictions who will similarly have to solve consumer problems with no common understanding of how third parties can or should engage with the market and no clear means of meeting consumer expectations.

ERAA members believe that there is a need for a comprehensive review of third party responsibilities to consumers and an examination of how third parties can be brought under consumer protection regimes – including the National Energy Consumer Framework (NECF) – efficiently and effectively. This should involve a clearer definition in regulation of what retailing energy is, as discussed below. It also requires the NECF and other state licensing frameworks to be amended to provide specific authorisations for certain service provider types. The key questions that should drive how we assess third parties relate to how the end user sees the service relationship, what rights they would expect compared to basic energy use, and how the risks of multi-party service provisions can be best managed and minimised.

ERAA position

The ERAA proposes that the overriding consumer protection principle should remain, which is that regulatory frameworks should reflect community expectations about how consumers are supplied with an essential service. In our view, "sale of electricity" (or energy more broadly) is no longer an adequate test of whether retail licensing or authorisation is required. The concept should instead shift to sale of *energy services*, which includes retailing energy *and* energy management service such as interruptions to energy supply (under direct load control or supply capacity control, for example), ongoing use of a consumer's meter data, as well as directly billing the consumer under contract.

More precisely, third party and distributor energy management service offerings should be judged on certain criteria, from the starting point that the third party/distributor will have access to a customer's consumption data. The criteria should be based on the core aspects of why retail contracts are currently regulated, such as the following:

1. If the product or service is marketed in competition with other services, and specific information needs to be provided at the point of sale to ensure informed consent.
2. If the consumer receives ongoing service under contract.
3. If supply to the property/appliance can be controlled or disconnected, including by charging technology.
4. If the consumer is billed or compensated directly from the service provider.

If the above activities occur in conjunction we believe that some form of retail licence or NECF authorisation is required. To avoid doubt, this means that distributors also would not be able to undertake these activities without such an authorisation, which requires ring-fencing between the retail activities and any monopoly service provision with regulated revenue streams. As a matter of competitive neutrality, distributors should not be competing in the retail space using regulated revenue; not only does this reflect competitive advantage compared with retailers but it is considered to be unlawful by the AER.[1]

The decision model in Figure 1 on the following page is a useful starting point to conceptualise the issues addressed above, and for completeness we have included criteria to assess sale of energy as well, and also incorporated the policy proposal from ERAA's *Working Paper 4* that all service providers should be subject to the National Privacy Principles (NPPs). Once this approach has been agreed it will then be important to assess the need for the current retail licensing schemes to be changed to provide for a more specific licence type, and for NECF in particular to be modified for special authorisations to be granted rather than the current one-size-fits-all version.

[1] See page 85 of Accenture (2011) *IHD Inclusion into ESI scheme: Final Report*, for Department of Primary Industries, Victoria, December.

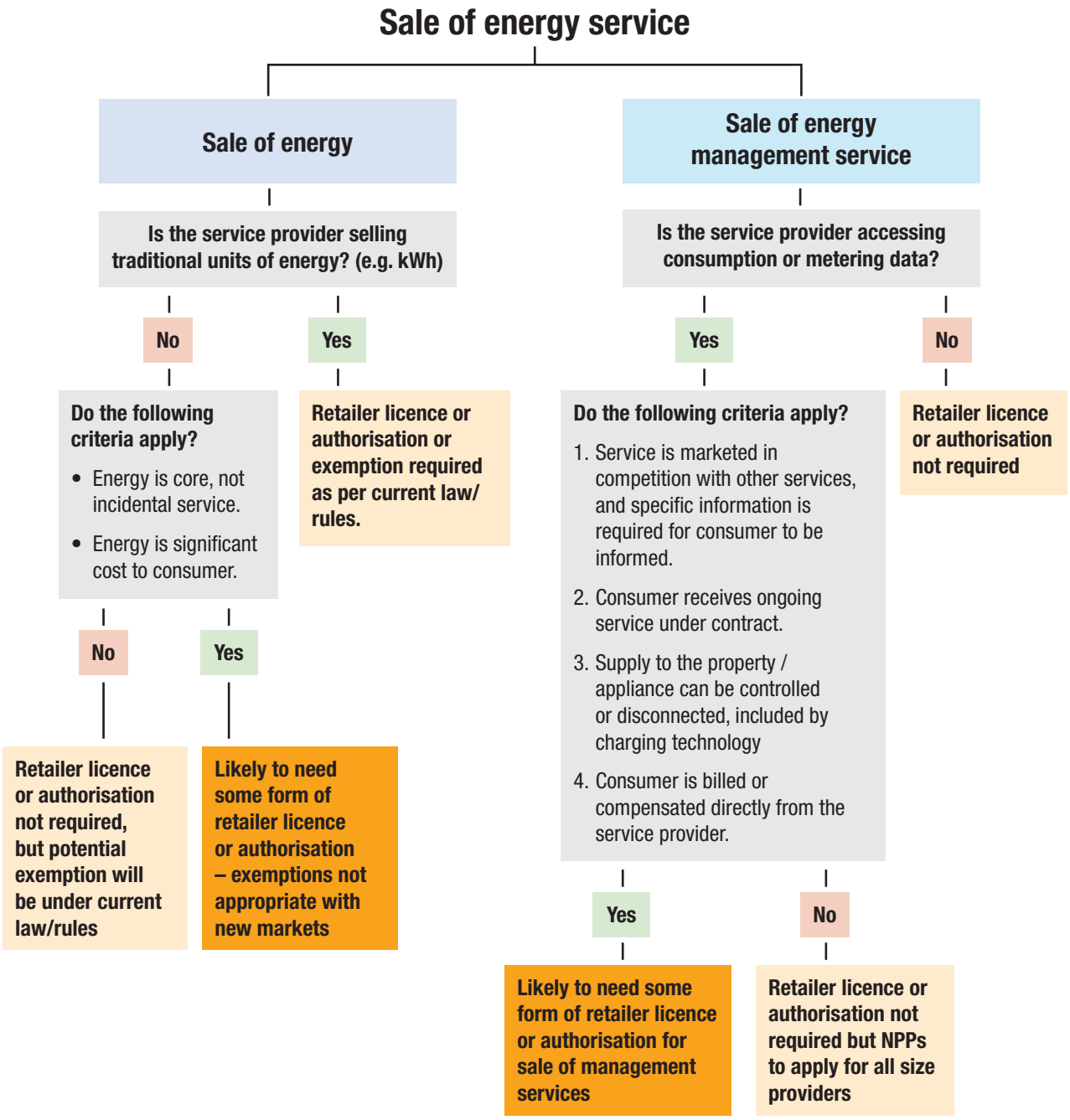

Figure 1: A proposed conceptual framework for new retail authorisations

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Energy Retailers Association of Australia Limited

28 September 2012

Mr Chris Pattas
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne Victoria 3001

By email: AERInquiry@aer.gov.au

Dear Mr Pattas,

RE: Electricity Distribution Ring-fencing Guidelines Position Paper

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide comments on Electricity Distribution Ring-fencing Guidelines Position Paper (the Position Paper). The ERAA supports the AER's preferred position as outlined in Section 3 of the Position Paper and will make specific comments to the draft guidelines when published in November 2012.

In support of our previous submission of 24 February 2012 to the Electricity Distribution Ring fencing Guidelines Issues Paper, we enclose two ERAA Smart Meter Working Papers to further articulate our position:

- *Competitive neutrality in energy service provision (Working Paper 3)*. This paper explores the relationship between competitive neutrality, ring-fencing and the long term objectives of National Competition Policy.
- *Third party and distributor sale of energy management services (Working Paper 5)*. This paper discusses the need for all participants selling certain energy services to adhere to the same consumer protection regime, and if applicable, be appropriately ring-fenced from their regulated network businesses.

More broadly, these papers outline ERAA member concerns with existing ring fencing guidelines, and in particular, their application in emerging contestable markets.

As highlighted in Working Paper 5 it is the ERAA's preferred position that where a service or product is deemed contestable as conceptualised under its decision model (Figure 1) that a distribution business be appropriately ring fenced and that all ring fencing obligations proposed in the Position Paper be imposed. Whilst this may be prescriptive, distribution businesses should have the ability to apply for a waiver, or variation, to the imposition of a certain obligation, through a public consultation process controlled by the AER. This process may appear to be rigid in its approach, however it will ensure sufficient onus be placed on distribution businesses that wish to offer services deemed contestable to the market as to why certain obligations should not be imposed. This will also help alleviate some of the ambiguity that currently exists

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in the market where distribution businesses offer services direct to customers, and deemed services that the contestable market can deliver, without any appropriate ring fencing provision being considered.

We look forward to providing further specific input to the draft guidelines when published by the AER in November 2012. Should you wish to discuss the details of this submission further, please contact me on (02) 8241 1800 and I will be happy to facilitate such discussions with my member companies.

Yours sincerely,

Cameron O'Reilly
Chief Executive Officer
Energy Retailers Association of Australia