

**Submission
No 38**

EMBEDDED NETWORKS IN NEW SOUTH WALES

Organisation: The Australian Energy Regulator

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Hon. Ray Williams MP
Chair of the NSW Committee on Law and Safety
Legislative Assembly
NSW Parliament House
6 Macquarie Street
Sydney NSW 2000

Dear Mr Williams

AER Submission – NSW Parliamentary enquiry into embedded networks

Thank you for the opportunity to contribute to the Law and Safety Committee's (the **Committee**) enquiry into embedded networks in New South Wales (**NSW**). The Australian Energy Regulator (**AER**) regulates wholesale and retail energy markets, and energy networks, in eastern and southern Australia under national energy legislation and rules. As part of our regulation role, we monitor and enforce compliance under these laws and rules to ensure customers are accorded the required protections.

We also assess authorisation applications from businesses that want to become energy retailers, and provide exemptions, subject to conditions, for businesses who do not require an authorisation. These businesses commonly operate in embedded networks and on-sell energy to residents or tenants at a given site.

Improving outcomes for consumers in embedded networks, including by enabling access to ombudsman schemes is a current Compliance and Enforcement priority for the AER.

As outlined in this submission, the AER has identified a number of potential harms that consumers living in embedded networks may face, but it also acknowledges the benefits consumers may receive. Where we have identified potential harms, the AER continues to explore ways to mitigate these issues and has made progress to improve outcomes for embedded network consumers. However, the AER equally recognises there are limitations and challenges with the current framework regulating embedded networks that impede customers receiving certain desired outcomes.

The AER is currently undertaking a review into the authorisations and exemptions framework and seeks to identify appropriate reforms to the framework.¹ This piece of work arises from the Energy Security Board's advice to the energy ministers in July 2021 on the Post-2025 Market Design Project. The Energy Security Board recommended that the AER conduct a review of the framework to assess whether it is suitable to protect consumers during the energy transition.²

¹ [Retailer Authorisation and Exemption review Issues Paper, April 2022](#)

² [Energy Security Board, Final advice to governments, ESB, 2021](#)

We will continue to work with stakeholders, including those in NSW, as we build on and progress our work in this priority area for the AER.

The AER's current role in embedded networks

The energy laws set the framework in which the current exemptions framework operates, and the parameters within which the AER implements this framework. Under the National Energy Retail Law (**NERL**), a person must be authorised by the AER to sell energy to customers or be exempt from holding an authorisation. Situations where an exemption is more appropriate include those where the seller is selling energy incidentally (i.e. the sale is not the seller's core business), where the cost of having an authorisation outweighs the benefits to customers, and where an insignificant amount of energy is being sold. Examples include retirement villages, caravan parks or shopping centres where an owner or manager buys electricity from an authorised retailer, then 'on-sells' it to residents or tenants. On-sellers are referred to as 'exempt sellers' and most embedded network owners or operators are also energy on-sellers.

Under the National Electricity Law (**NEL**) anyone that supplies electricity through an electricity network – transmission, distribution or private – must be registered with the Australian Energy Market Operator (**AEMO**) or be exempt from registration. The AER may exempt electricity networks where the costs of registering with AEMO would be burdensome and unnecessary, for example small, private networks. Electricity supply in these networks is generally not core to the business, for example embedded networks where the owner or operator is also the property owner, landlord, or body corporate.

AER Guidelines and categories of exemption

The energy laws require the AER to develop and maintain exemption guidelines that regulate issues relating to the supply and sale of energy in embedded networks. The AER administers both retail and network exemptions through the Retail Exempt Selling Guideline (**Retail Guideline**) and Network Exemptions Guideline (**Network Guideline**). These guidelines set out the processes for registering and applying for exemptions, and outline the various exemption classes, their eligibility criteria and exemption conditions that entities must comply with to ensure customers have appropriate protections. They also detail our policy considerations when making decisions on exemption applications and on exemption classes and conditions.

There are three different ways a person can be exempt – they can be deemed, register through an online form or apply for an individual exemption.

A *deemed* exemption applies automatically to certain classes of energy suppliers and sellers. A person covered by a deemed exemption does not need to apply or register with the AER. Deemed classes are usually for small-scale selling or supply arrangements that we consider need minimal regulatory oversight. Most, however, are still subject to conditions. Deemed exemptions apply to a range of activities, including:

- caravan parks or holidays parks that sell or supply metered energy to people in short term holiday accommodation;
- businesses that sell or supply energy to a related business; and
- persons who sell or supply metered energy to fewer than ten small businesses or residents.

We consider that more regulatory oversight is warranted where the scale of the energy sale or supply is greater. These exemptions need to be *registered* on the AER's public register (but we do not assess or approve them). Like deemed exemptions, registrable exemptions apply

to certain classes of energy sellers. All registerable exemptions are subject to conditions. The following are examples of registerable exemption classes for the sale or supply of energy to:

- more than 10 residential customers;
- caravan parks with permanent residents; and
- large customers.

Individual exemptions are for unusual or unique energy supply or sale arrangements not covered by the class exemptions; these are relatively few in comparison and allow us to tailor the conditions of the exemption to the specific situation. A person must apply to the AER to be granted an individual exemption. Individual exemptions are also recorded on the AER's public register.

Conditions imposed on exemption holders

Exemption holders have to follow strict conditions and meet a range of obligations to their customers (detailed in the guidelines). Conditions are based on the obligations that apply to authorised retailers and distribution network businesses, but are a lighter, less prescriptive form of regulation and are appropriately tailored according to the nature of the embedded network or the energy sale. Retail conditions include key customer protections such as billing and charging, information disclosure, life support, payment plans, and de-energisation and re-energisation. Network conditions relate to safety, metering, access to competition and pricing. Failure to meet retail exemption conditions is a Tier 1 civil penalty provision and can attract substantial penalties.^{3 4}

Embedded network issues

The AER has identified potential harms customers may face in embedded networks. We largely attribute this to the inherently monopolistic nature of embedded networks and a framework that is no longer fit for purpose to regulate the proliferation of embedded networks. We consider many issues in embedded networks are structural in nature and that many of the issues could at least be mitigated by removing the impediments to competition.

Some of the key harms we identify include the following:

- Customers in an embedded network are permitted to buy electricity from either an authorised energy retailer or the embedded network (as an exempt seller). However, in practice, consumers in an embedded network often have difficulty buying energy from a seller other than the exempt seller, so have limited retailer choice. This is due to the way the network may have been wired or metered or because energy retailers may not want to sell to a consumer inside an embedded network.
- Without competitive pressure to lower prices in embedded networks, exempt sellers (and retailers selling in embedded networks) may charge higher prices than those available to customers directly connected to the grid.
- For many embedded networks, the on-selling of energy is incidental to their core business and they may not have the administrative resources, sophistication or understanding to ensure customers in payment difficulties or life support customers are afforded the required protections.
- There is an absence of Retailer of Last Resort (**RoLR**) protections for off-market embedded network consumers supplied by an authorised retailer who is no longer able to offer energy. This means that should an authorised retailer in that

³ s 112(2), *National Energy Retail Law*.

⁴ The *Statutes Amendment (National Energy Laws) (Penalties and Enforcement) Act 2020* recently changed the applicable penalty rates.

circumstance become insolvent or otherwise cease supply, the AER is able to transfer that retailer's on-market customers to a RoLR, but not its off-market customers within embedded networks. In such situations, the AER has no regulatory mechanism to facilitate continuity of supply for these embedded network customers or direct another retailer to assume supply obligations for the off-market customers. It would be up to the customers to seek to negotiate new arrangements to avoid a potential loss of supply. The AER will seek to assist by providing up to date information about the RoLR event and implications on affected customers and consider, where practicable, to contact each embedded network (in most cases a body corporate or owners corporation) to encourage them to seek alternative supply themselves.⁵

The exemptions framework established in the NERL was designed to regulate a relatively homogenous and simple energy retail market where the sale of energy in embedded networks was regarded as an incidental aspect of the relationship between a landlord or body corporate and the occupants of a site. While the exempt selling framework was developed to manage this arrangement, we have seen an increasing number of embedded network owners and operators on-selling for profit and the emergence of businesses that specialise in operating in embedded networks. Whereas embedded networks were once relatively uncommon, they are now commonplace and still growing.

We observed that embedded network owners and operators are a diverse collection of individuals or businesses that have markedly different resources, expertise and motivations making it impracticable for them to provide the same level of consumer protections as retailers in many instances. Added to this, embedded network owners and operators often have more complex relationships with their customers than retailers do, as they can also be landlords and provide other services. Such relationships are governed by other legislation (e.g. tenancies legislation, body corporate legislation, and caravan park legislation), which place further – sometimes conflicting – obligations on embedded network owners and operators in relation to energy sales that are divergent from retailers' obligations.

The AER's current work

While we have identified certain consumer harms in embedded networks, we acknowledge that embedded networks may also bring benefits to consumers, particularly in terms of potential cost savings, and being a potential source of innovation that consumers value. The AER has observed scenarios where consumers in retirement villages, for example, have sought and instigated the conversion of their village to an embedded network to access cost savings. In other instances, we have observed cost savings for consumers in shopping centres being attributed to the installation of solar PVs at the site.

In respect of consumer harms, the AER has considered these issues in our remit of work. In May 2021, we commenced a review of both our Network and Retail Guidelines and consulted extensively with various stakeholders in NSW. While many issues identified above are outside the scope of the guidelines, the AER has taken steps as part of the review to mitigate some of these issues. By way of example, the absence of RoLR protections is outside the scope of the guidelines so we are currently consulting with the AEMC to reform the current RoLR regime to extend these protections to embedded network consumers.

In meantime, the AER published its draft Retail Guideline (Version 6) in March 2022 and aims to release the final version in early July 2022. The amendments to the draft guideline are designed to increase protections for consumers living in embedded networks as well as make exempt sellers' obligations clearer. Key changes include:

⁵ The AER has provided input to the AEMC in this regard in relation to its urgent re-examination of its 2021 Review of the RoLR scheme being undertaken pursuant to the [Energy Ministers' Communique dated 8 June 2022](#).

- the introduction of a new condition to require exempt sellers to have a hardship policy. This condition is designed to ensure residential customers in embedded networks who experience payment difficulties due to hardship can have access to adequate support to better manage their energy bills,
- the introduction of a new information provision condition for exempt sellers to provide their customers with an AER factsheet. This factsheet sets out for these customers the process, and the difficulties they may face, if they want to purchase energy directly from a retailer,
- clarifying our expectations that conversions to embedded networks must only occur when prospective customers are fully informed of the impacts and provide their consent, and
- the introduction of a requirement to provide evidence of steps taken to obtain ombudsman scheme membership, as part of the individual exemption application process.

In respect of the draft Network Guideline (Version 7), the AER has decided to defer its release while further changes are made to streamline and simplify this guideline. The review of the Network Guideline is ongoing and is planned for final release in late 2022. We are reviewing this guideline with a view to improving the clarity and readability of exemption conditions, clarifying concepts such as the issue of the ownership, control, and operation of embedded networks, and strengthening consumer protections where possible.

Conditions imposed on exemptions are designed to ensure consumers in embedded networks are not denied the consumer protections afforded to consumers of authorised retailers, as far as practicable. The AER imposes conditions on the business as part of its decision to grant individual exemptions or permit eligibility to rely on a registrable class exemption. To address some of the harms above, we impose conditions on all embedded networks with residential customers, for example, the prohibition to charge consumers tariffs higher than the standing offer price to protect consumers from unreasonably high prices; and the requirement to become members of the relevant ombudsman scheme (including EWON) to ensure consumers have access to this important dispute resolution service. Failure to adhere to these conditions is a breach of the NERL and may attract civil penalties.

Given ombudsman membership is currently a specific priority for the AER, we have engaged in a range of compliance activities to ensure customers in embedded networks can access dispute resolution services through ombudsman schemes. Activities include:

- contacting various industry associations related to caravan parks, retirement villages and similar (as well as contacting exempt sellers directly) to communicate the AER's expectation on compliance under this condition,
- formalised a referral process with EWON (and the other ombudsman schemes) to ensure exempt sellers that have failed to become members are efficiently identified and notified of the condition, and
- following up exempt sellers who continue to fail to join EWON (and other ombudsman schemes).

These activities have resulted in an increase in the number of exempt sellers who are members of EWON. The AER will continue to work closely with EWON to ensure greater compliance in this area.

We are also currently considering submissions received in response to the AER's Authorisations and Exemptions review issues paper.⁶ The issues paper acknowledges that

⁶ [Authorisation and Exemption review submissions](#)

the consumer harms we have identified in embedded networks is likely to be exacerbated in a transitioning energy market. The review aims to release draft recommendations in late 2022 on potential reforms to the exemption framework in the energy transition, including whether we need to consider limiting the scenarios that may permit exemptions and the establishment of new embedded networks⁷. In so doing, it will consider the package of recommendations put forward by the AEMC in its 2019 review of the regulatory frameworks for embedded networks. The AER will consult closely with the AEMC to inform potential reforms that could be progressed.

We note an existing challenge with the current exemptions framework is the lack of regulatory visibility over exempt sellers and embedded network owners and operators. While we are currently considering this issue as part of the Authorisations and Exemption review, the AER will also continue to work closely with EWON to progress the work to identify and refer complaints relating to non-compliance by embedded networks to the AER. This avenue of work is intended to assist addressing issues of visibility to an extent.

Current trends in New South Wales

Network exemption registrations give an approximate size of the embedded network market.⁸ In New South Wales, there were 1551 network exemptions registered on the *AER public register* as at 22 June 2022. This represents 25% of all registered network exemptions for states participating in the National Electricity Market. There was an increase of 18 percent in network exemptions registered for New South Wales compared to the same time last year.

In New South Wales, the single largest registered embedded network class is for supply of electricity to residential customers and makes up about 50% of the total. By contrast, supply of electricity to small commercial/retail customers makes up about 17% of the total. While the supply of electricity to residents of caravan parks and retirement villages make up a further approximate 13% and 3% respectively.

In the financial period of 1 July 2021 – 30 June 2022, the AER received 22 contacts from customers in embedded networks in NSW. This represents 15% of the total embedded network related complaints/enquiries during this period. The complaints/enquiries related to various questions about pricing such as bulk hot water charges and whether customers in an embedded network can be charged a daily supply charge in an embedded network; and accessing competition, including not receiving the relevant information or support for how to go 'on-market'.

Customers who contact the AER with a complaint or enquiry are provided with information about their enquiry or practical steps to help them resolve their complaint, where appropriate. We also consider potential breaches of exemption conditions and escalate matters into formal investigations as necessary. As the AER works with EWON and other ombudsman schemes to gather intelligence around potential issues of non-compliance, we will continue to escalate matters where warranted.

Previous matters where the AER has taken enforcement action include the issuing of infringement notices on Stockland Corporation Ltd and Discovery Parks for allegedly selling electricity to customers without holding the appropriate retail exemption, as required under the NERL.

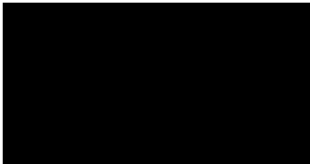
⁷ [AEMC, Review of Regulatory Arrangements for Embedded Networks, 2017](#)

⁸ The actual number of embedded networks is invariably higher as small embedded networks (i.e. fewer than 10 customers) are deemed and do not appear on the AER's public register. There is also likely to be a embedded network operators who are unaware of their obligations to hold an exemption.

Given consumer outcomes in embedded networks is a priority area for the AER, we will continue to progress our focus towards improving these outcomes. The Authorisations and Exemptions review will build on the AER's work and consider potential future reforms to the framework to further support this priority area.

We thank the Committee for the opportunity to submit on this process. If you have any questions about our submission, please contact [REDACTED], [REDACTED]
[REDACTED]

Yours sincerely

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Jim Cox
Deputy Chair