



16 February 2015

Ms Sarah Proudfoot
General Manager, Retail Markets Branch
Australian Energy Regulator
Level 35, The Tower
360 Elizabeth St
Melbourne Victoria 3000

via email: AERInquiry@aer.gov.au

Dear Ms Proudfoot

AER Issues Paper – Regulating innovative energy selling business models under the National Energy Retail law

The ENA welcomes the opportunity to provide a submission to the AER in response to the Issues Paper titled *'Regulating innovative energy selling business models under the National Energy Retail Law'* published by the AER on 18 November 2014.

The Energy Networks Association is the national industry association representing the businesses operating Australia's electricity transmission and distribution and gas distribution networks. Member businesses provide energy to virtually every household and business in Australia. ENA members own assets valued at over \$100 billion in energy network infrastructure.

The current consultation follows the release by the AER in June 2014 of a statement of approach for *Regulation of Alternative Energy Sellers under the National Energy Retail Law* which focussed on businesses selling electricity through solar power purchase agreements (SPPA's). The ENA notes that the current consultation is premised on a distinction between suppliers providing energy under Solar Power Purchase Agreements (SPPAs) and the emergence of storage and other potential technologies permitting the sale of additional energy services. AER seeks feedback on the implications of storage and other emerging technologies on regulation of selling models; two regulatory options; and conditions and trigger points which should apply if Option 2, a framework reliant on exemptions, is adopted.

Significance of New Technologies and Business Models

The ENA and network businesses support the development of a vibrant, innovative market based on distributed energy resources, including onsite generation and storage. There are significant potential benefits to electricity customers in the economic utilisation of such technologies and the emergence of customer-focussed energy services and products which provide benefits to customer control over energy use, convenience and long-term affordability. In an economically efficient regulatory environment, potential benefits can be realised for both individual customers taking up new technologies and those customers who do not, yet still benefit from system-wide efficiencies (such as improved energy balancing) realised through network integration. Recent economic analysis commissioned by the ENA from Energeia identified the potential for approximately 35 GW of efficient Solar PV and Storage investment by 2034, in an environment of cost-reflective electricity tariffs, including approximately 7 GW of storage capacity and 27 GW of solar PV capacity¹.

Australian electricity networks are playing an important role in facilitating the economic uptake of distributed energy resources, including through the connection of over 1.3 million rooftop solar photovoltaic (PV) systems to date; trials in storage and other innovative technologies; and the development of new standards in collaboration with other stakeholders. The ENA and its members continue to support related regulatory reforms including the forthcoming review of the Demand Management and Embedded Generation Incentive Scheme, to promote the economic utilisation of distributed energy resources.

In this dynamic market environment, it is in the long-term interest of electricity consumers that unnecessary barriers to entry in competitive energy markets should be avoided. However, it is equally important that the emerging market environment takes into account the principles of competitive neutrality and that networks, regulators and policy makers do not seek to 'pick winners' or advantage one form of energy service provider over others. In this submission the ENA argues that full retail authorisation for innovative energy selling business models is not warranted however the AER should continue to consider in the future the impacts on competitive neutrality of proposed regulatory approaches to incumbent businesses and new entrants.

Approach to Review

ENA considers that the current approach by the AER to reviewing its regulation of innovative energy selling business models should be approached in manner which is:

- **Comprehensive**, systematically addressing issues related to the regulation of energy services relying on solar technology, storage technology and the emergence of micro-grids with a view to establishing an integrated, coherent regulatory regime; and
- **Coordinated**, recognising the current consultation initiated by the COAG Energy Council's Energy Market Reform Working Group on directly related matters.

The ENA notes the COAG Energy Council has commissioned a review which is currently the subject of overlapping consultation titled *New Products and Services in the Electricity Market*:

¹ Energeia, *Network Pricing and Enabling Metering Analysis*, November 2014

Consultation on Regulatory Implications. In December 2014, the Energy Market Reform Working Group (EMRWG) released a consultation paper seeking feedback by March 2015.

The two options in the AER's current review rely on the adaptation of existing elements of the authorisation framework, rather than proposing a regulatory framework which is fit for purpose and resilient to the dynamically changing market environment. The AER recognises the 'strain' which the existing framework is being placed under on page 6 of its Consultation Paper:

While the AER has used the exemptions framework to regulate businesses selling energy through SPPAs, we are concerned that the Retail Law is not equipped to deal with many emerging energy retail models. As such, there are significant challenges in applying the authorisation/exemption distinction in those cases and it may be timely to revisit the framework more generally.

The ENA agrees that it is timely to revisit the framework more generally and urges the AER to do so, in the comprehensive, coordinated manner suggested above. This would permit the full evaluation of significant issues raised in this submission including:

- Opportunities to achieve more efficient or light-handed regulatory obligations for all sellers, including retailers, alternative sellers and innovative business models;
- Deficiencies in the current criteria for determining if a seller is eligible for exemption from authorisation, including "whether the seller is the primary source of energy";
- The need to consider the implications of competitive neutrality principles in the regulatory obligations which apply to all market participants;
- The need to publish appropriate criteria for the application of customer protection regulatory obligations on sellers (whether those obligations are conditions of an exemption or under a new authorisation framework) based on analysis and consultation.

Such an approach is best suited to achieving a regulatory regime for consumer protection which is consistent with the best practice principles, such as those identified by the Council of Australian Governments in 2007², including:

- A case for action should be established before addressing a problem;
- The option with the greatest net benefit for the community should be adopted;
- Regulation should remain relevant and effective over time; and
- Action should be effective and proportional to the issues being addressed.

² Council of Australian Governments, *Best Practice Regulation - A Guide for Ministerial Councils and National Standard Setting Bodies*, October 2007.

It may be that the AER is concerned about the delay that a more integrated review may cause. However, this would be preferable if significant issues are to be only partially addressed in the current review process. In this context, it is noted that the AER proposes to publish its final position in Quarter 2, 2015 but notes:

*We may, in future, make alterations to our Exempt Selling Guideline (including setting appropriate conditions) and Retailer Authorisation Guideline to further explain our treatment of alternative energy sellers under the Retail Law.*³

The ENA supports the AER adopting a principles-based approach in the current review, however it is also important that this is expressed in a transparent decision-making framework that provides adequate guidance in relation to the potential regulatory obligations (conditions) which could be imposed; and the general criteria which will determine their application. As noted in this submission, the ENA considers that the current exemption criteria and the potential triggers (based on scale) are not consistent with a fit for purpose regulatory outcome. These issues are fundamental to the clarity of the regime as a decision-making framework and it is preferable that they are not deferred to a subsequent process.

Given the dynamic, competitive market environment, it is strongly preferable to achieve a regulatory framework which increases the *ex-ante* understanding among potential market participants of the basis for regulatory obligations, rather than relying on a loosely-defined exemptions framework which sees the selective application of conditions by the Regulator on the basis of individual applications.

Deficiencies in the current exemption criteria

The AER's current Statement of Approach for the regulation of alternative energy sellers indicates that a key criteria determining whether an alternative energy seller is likely to require authorisation is "... *whether the seller is the primary source of energy to the premises of a small customer for a particular fuel*". This principle results in the alternative energy seller being granted authorisation exemption. This exemption applies minimal conditions compared to the obligations to provide customer protections under the National Energy Retail Law that apply to an authorised energy seller. It has direct consequences for the responsibility of the seller in relation to customer protection; and the relative contribution of participants in the competitive energy market to customer protection measures. This in turn has implications for competitive neutrality as discussed below.

The AER generally considers that SPPAs do not meet the criteria requiring authorisation but there is the potential for innovative business models, such as energy storage, to do so in the future.

The ENA considers that this criteria and its application are in need of revision because:

- the framework does not reflect the significance of the SPPAs to customers or the need for consistent consumer protection; and

³ AER, Issues Paper, *Regulating Innovative Energy Selling Business Models under the National Energy Retail Law*

- It is not an appropriate basis for assessing the fit-for-purpose regulatory obligations that should apply to the supply of energy services in the emerging market environment.

Australia has world leading rates of rooftop Solar PV penetration, with installations at up to 27% of dwellings in some jurisdictions.⁴ The installed capacity is forecast to exceed 10,000 MW by 2020, according to the Australian Energy Market Operator. There is evidence that the average size of rooftop PV being installed is increasing.⁵ Numerous network locations have been identified which are net exporters of energy.

It is evident that an investment or contract for Solar PV supply is highly significant both to the energy supply and financial outcomes of those Australian electricity consumers. Recent analysis by Oakley Greenwood identified a typical rooftop PV system produces 3,742 kWh per annum under average weather conditions, equivalent to 75% of the total 5,000 kWh per annum consumed by a residential customer.⁶ Of this output from the solar PV unit, 2,044 kWh per annum (or 55% of the output) was consumed directly by the household. Whether acquired via power purchase or direct investment, a solar PV installation represents a significant financial commitment to meet costs (upfront or overtime) in the order of 3 to 10 times their current annual electricity bill.

Consequently, the ENA does not consider that current criteria (or its interpretation in relation to SPPAs) remains an appropriate basis to determine whether a seller is responsible for customer protection under the National Energy Retail Law. While the ENA supports the AER's view that that innovative business models (including storage services) will only increase the reliance of customers to new sellers, the framework requires review in its current application to alternative energy sellers also.

Need to consider competitive neutrality principle in the regulation of energy services markets.

The ENA is concerned that the current regulation of alternative energy sellers and proposed regulation of innovative business models, may not maintain competitive neutrality in the market for energy services, specifically between 'traditional' and 'non-traditional' sellers. As noted below, the ENA's concern arises not because of the financial impacts on 'traditional' sellers but because of the long-term interest of consumers. Consumers collectively pay more under regulatory regimes which do not promote genuinely efficient competition on level playing fields. Some consumers who do not adopt new technology are unfairly disadvantaged if regulatory regimes permit unintentional cross-subsidies to new adopters of technology at their expense.

The AER consultation paper recognises this potential, stating:

If the customer remains connected to the grid through a contract with a separate authorised retailer, that retailer will incur all relevant costs and risks but is likely to see reduced financial return from that customer who is able to store and then use energy generated through its SPPA. It is arguable that this imbalance has the potential to result in an uneven playing field

⁴ Australian PV Institute website (<http://pv-map.apvi.org.au/historical#4/-26.67/134.12>) accessed 28 January 2015

⁵ Oakley Greenwood (2014) *Value of a Grid Connection to Distributed Generation Customers*

⁶ Oakley Greenwood (2014), *ibid.* page.17

between authorised retailers and alternative energy sellers. This was certainly the view expressed by retailers during the 2013 consultation on regulating alternative energy sellers.⁷

An exemption framework has the potential to create unfair competition, to the extent it provides for inconsistent consumer protection requirements related to comparable services. This may occur, for instance, where an alternative or innovative energy seller is not subject to National Energy Customer Framework requirements in relation to billing, management of payment plans or rules pertaining to management of supply to customers on life support.

As the AER recognises, the principles in section 114 of the National Energy Retail Law, include that:

- (a) *regulatory arrangements for exempt sellers should not unnecessarily diverge from those applying to retailers...; and*
- (c) *exempt customers should, as far as practicable, not be denied customer protections afforded to retail customers under this Law and the Rules.*

It is appropriate for the AER to assess the effectiveness of the regime in the context of the National Electricity Objective, which goes beyond minimising barriers to entry of new service providers but the efficiency of the total cost outcome for all consumers.

In the context of network pricing reform, the COAG Energy Council recently articulated a key principle of regulatory design that:

The Council supports consumers' right to take up new technologies, but recognises that this should not be on the basis of cross-subsidies from other end users...⁸

The ENA considers that competitive neutrality concerns already arise in the existing framework relating to the regulation of alternative energy sellers and that the AER should use this opportunity to assess these concerns.

Potential to address competitive neutrality principle in 'Option 2'

The AER's current review should ensure a clear, transparent framework for both alternative sellers and innovative business models, which takes into account competitive neutrality principles and avoids free-riding, cross subsidies or cost transfers under Option 2, the AER contemplates options to address competitive neutrality issues and the need for consumer protection, including by proposing:

- the discretionary application of potential conditions to the exemption; and
- a condition for a review of the exemption at a trigger point.

The consultation paper states:

⁷ AER Consultation Paper, p.8

⁸ COAG Energy Council, Meeting Communique, 11 December 2014, p2

In responding to this issue, we remind stakeholders Option 2 would involve conditions being imposed on an exempt seller that would largely mirror the obligations on a retailer when size or scale makes this appropriate.⁹

While it would be possible for an exemptions framework to be developed which does apply consistent obligations on an exempt seller to an equivalent retailer, this would require significant further development beyond the current definition of Option 2 in the consultation paper. For instance,

- The AER appears to assume a continuing “ad hoc” approach to setting conditions on each exemption application. Given the competitive market environment, it is strongly preferable to achieve a regulatory framework which increases the ex-ante understanding of the basis for regulatory obligations rather than relying on selective application of conditions on the basis of individual applications.
- To achieve an appropriately transparent framework, it would be necessary to develop and consult on explicit criteria which are intended to determine which specific regulatory obligations (conditions) would be imposed on market participants based on the features of the services they provide.
- While a framework of ‘triggers’ suggested by the AER may be developed, the three examples provided are indications of the significance of the service provider **in the market** (eg. sales volume, customer base, or storage capacity). However, these criteria do not recognise the relative significance of the service provided to the exempt customers by that seller and the need, if any, for those customers to receive the benefit of an energy specific customer protection framework.

Conclusion

The threshold issues identified above underscore the ENA’s earlier recommendation that the AER revise its approach and progress a more comprehensive review of the regulatory regime for alternative energy sellers and innovative business models, including natural gas, in a coordinated manner with the review COAG Energy Council review.

It is noted that the AER’s approach to the review generally assumes a continuation of the current policy and legal framework under Option 1 (“Authorisation”) or Option 2 (“Exemption”), rather than the ability to augment the framework to provide fit for purpose regulatory obligations on a consistent basis

It may be that the AER’s evaluation of these issues identifies the scope to apply light-handed customer protection obligations, including recommending changes to the application of the obligations under the National Energy Customer Framework or National Energy Retail Law. However, to the extent that is possible, changes should be progressed on a consistent basis for equivalent service features, rather than through differential treatment of some delivery models.

⁹ AER Consultation Paper, p.9

Finally, we note that significant innovation is taking place in the natural gas services market as well as electricity markets. An example of this is the development of small cogeneration plants that provide both electricity and hot water for residential and commercial use. These broader energy market developments highlight the value in examining these issues in a wholistic energy market process which considers the broad range of energy service and market developments, and new products. ENA, in this regard supports the Energy Market Working Group's recently announced review of new products and services examining these issues in the wider electricity and gas market context.

Key messages

- **The AER acknowledges that the exemptions framework is currently challenged and should therefore approach the review in a manner which is appropriately comprehensive and coordinated with other related review processes and include natural gas.**
- **ENA notes that both the current criteria ("primary energy seller"), and its interpretation in relation to SPPAs, is no longer appropriate and requires review**
- **The ENA does not support a full authorization framework for innovative business models.**
- **The ENA supports a light-handed regulatory framework which is fit-for-purpose and based on transparent decision-making criteria.**
An exemptions framework, as per AER's Option 2, could be viable but it would require development of clear principles-based criteria for application of customer protection requirements.

The ENA welcomes the opportunity to participate in the further development of this review, if you have any questions please contact me on 02 6272 1555 or Jim Bain on 02 6272 1516.

Yours sincerely



John Bradley
Chief Executive Officer