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Department for
Energy and Mining

DEMC23/01823

Mark Feather
General Manager, Policy
Australian Energy Regulator
GPO Box 3130
CANBERRA ACT 2601
Via email: AERexemptions@aer.gov.au

Dear Mr Feather,

Review of the AER exemptions framework for embedded networks – Issues Paper

The Strategic Policy and Delivery Division (the Division) of the South Australian Department for Energy and Mining thanks you for the opportunity to comment on the *Review of the Australian Energy Regulator (the regulator) exemptions framework for embedded networks - Issues Paper*.

The Division acknowledges that issues with embedded networks have existed for many years and improvements to these supply arrangements are needed.

It is important to recognise that the exemptions framework was initially conceived to regulate instances where the supply and sale of energy was regarded as an incidental part of the relationship between consumers and the business operator. Following the growth in embedded networks, where the supply arrangement has been used to the benefit of large business, the original intention of the framework should not be lost.

We note that improvements to the current framework need to be made for the benefit of all customers in embedded networks, particularly given the increase in these supply arrangements nationally and the potential for vulnerable customers to be over-represented in them. It is reasonable to think that embedded networks should only exist where benefits are provided to the consumers within the network, and not just to the operators of these networks.

The Division considers that amendments to the regulator's Guidelines are the most efficient, and nationally consistent way to overcome issues that currently exist in embedded networks for consumers. As the body responsible for administering both retail and network exemptions through the Retail Exempt Selling Guideline (Retail Guideline) and Network Exemptions Guideline (Network Guideline) the regulator is best placed to resolve many of the current issues in light of recent market trends. We also note the Networks Guideline provides the opportunity to curb the growth of embedded networks.

The framework was developed to manage various selling arrangements, but as the number of embedded networks grow, and as the intention of the new embedded network operators is to sell for profit, we consider the role of the regulator in administering the exemptions framework should also evolve.

We consider the proposed criteria to guide the regulator's assessment of options provided in the Issues Paper are appropriate. However, the administrative cost for the regulator

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should be a criterion with lesser weighting. The status quo is not considered appropriate, and the regulator is the appropriate body with the ability to make a difference, whether it be in the process of approving exemptions, or monitoring compliance. It is difficult to see any improvements being made in a proper manner without an impact on the administrative undertakings of the regulator.

With regard to the regulator's desire to seek evidence from stakeholders to determine the scale and severity of the potential harms and benefits of embedded networks, we suggest the regulator refer to the South Australian Parliament's *Economic and Finance Committee - Inquiry into Embedded Networks in South Australia* which contains evidence from 16 witnesses representing a range of regulatory bodies, electricity companies, community organisations and peak bodies involved in embedded networks.

Submitters to the Inquiry demonstrated that embedded networks brought significant financial benefits to consumers through collective negotiations with a retailer on behalf of multiple child connections, and that some consumer protections are contained within regulation. However, various issues with the existing framework were also highlighted.

The Inquiry noted that the ability to choose a retailer was not an option for many customers due to a new retailer's difficulty connecting to the child meter. Consumers could also bear costs associated with leaving an embedded network for a NEM retailer as they could be liable for installation of a compliant meter or additional wiring costs.

Customers could pay higher rates than standard customers as there is limited transparency regarding whether landlords, shopping centre managers or body corporates passed on the savings of participating in an embedded network to their tenants or residents. Importantly, the Inquiry mentioned the disproportionate volumes of vulnerable customers in embedded networks who were more likely to be suffering economic hardship, particularly in the wake of the COVID-19 pandemic.

The Division encourages the regulator to obtain any relevant data from residential embedded network customers to further understand the exact impact these issues are currently having on consumers and participants in embedded networks.

Consideration should also be given to the fact that all embedded networks are different. Embedded network operators and service providers often differ by size, the service they provide, their registration or authorisation status and the type of embedded network they manage. There are also a wide range of different commercial and contractual arrangements that exist. It is understood that while some embedded network operators may earn high margins from on-selling electricity, others do not, while others may pass these savings on to consumers, and so price and non-price outcomes for customers can differ widely. This all means that the impact of any changes to the framework may be very different depending on the situation at each embedded network.

Any increase in protections for embedded networks customers would assist in providing consistent treatment for most small customers, including through greater access to retail competition and the extension of consumer protections. However, the changes to enable this





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outcome to occur are often not costless and could be passed on by, sometimes small, exempt entities to customers. The difficulty is finding the appropriate balance. The impacts of various change therefore need to be carefully considered by the regulator.

We understand the regulator's focus on higher-density residential embedded networks such as apartment complexes, given the growth in these types of dwellings and the concerns raised in this customer group. However, this should not mean the review does not consider improvements to arrangements for other embedded

network groups such as retirement villages and lower-density residencies, where other issues have been raised. Further, while improvements for future embedded network customers are most certainly required, enhancements for existing embedded networks should not be forgotten.

The Division would also like to acknowledge recent developments in South Australia that do not meet the traditional definition of an embedded network, but have been granted exemption status leading to the commencement of operations.

We understand that in a certain example all exemptions were granted (or deemed) by the regulator for a development and the proponents proceeded on this basis. It was only at a later time that other parties raised concerns with the approach adopted.

While the appropriate treatment of these alternate supply arrangements is still a matter for market bodies to determine (and we encourage the regulator to consider addressing these different methods of forming 'embedded networks' within this review), the matter does suggest that a greater level of scrutiny of exemption approvals is warranted to avoid situations where parties dispute a supply arrangement well after exemptions are granted (or deemed) and operations have commenced. Whether this is a result of a failure in the application of the guideline, or in the guideline itself, is debatable. Regardless, issues such as this highlight that inadequacies in the framework can lead to significant confusion, disruption and potentially cost to businesses and consumers.

Regarding the specific issues raised in the Issues Paper, we consider greater transparency of embedded networks, and the number of customers they serve, is critical to understanding the true extent of the problem (option 1). It would allow for more information to be given to customers and will also enable reporting levels to improve and therefore impact compliance. We therefore support all residential embedded networks being recorded on the regulator's public register of exemptions, and for this register to be easily accessible by all parties. While smaller embedded network service providers ability to comply with the requirement to register would need to be considered, it is assumed the information to be submitted to the regulator would not be overly onerous for these parties.

Embedded networks providers should also be required to confirm that their networks are beneficial to customers. A self-assessment by embedded network operators under an automated process (option 2) should be considered the minimum standard, however there would be little confidence that exempt embedded network service providers are actually providing benefits to consumers under this approach. It may therefore be considered a somewhat limited improvement to the current framework.





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The preferred option to enable a more certain level of improvement in the framework would therefore be for the regulator to assess network exemptions via an application process (option 3). The application would need to prove to the regulator that the embedded network provides tangible benefits to customers.

While the regulatory burden on the regulator is a matter for consideration, this could be overcome to a degree by limiting the approach to certain exemption classes (such as the NR2 class, perhaps initially) to reduce the number of assessments required. Charging applicants a small fee to cover administrative costs is another option for consideration. The parties covered within this category should be of a sufficient size and capability to meet these requirements, and any potential cost. If establishment of an embedded network is sufficiently attractive to parties, then an additional fee should not be a significant burden. Given the significant growth in the NR2 category in recent times it is considered the most appropriate category to place this requirement on, with other categories potentially included over time.

As the Issues Paper notes, this option may be a modified version of the current assessment undertaken for individual exemptions to, again, limit the burden on the regulator. It is unclear if this option could also extend to retail exemptions, with assessment of customer benefits covering prices paid by customers, and ensuring whether any benefits received by the embedded network operator are passed on to consumers.

We consider a more rigorous monitoring and enforcement regime will improve the operation of the existing framework and should therefore be strengthened for the benefit of all embedded network customers (option 5). The regulator's current use of information provided by ombudsman schemes, embedded network customers and other regulators is an important element in assessing the performance of exempt entities and identifying non-compliance, but it should not be relied upon in isolation. The retail exemptions framework should require exempt entities to provide more periodical information regarding their operations and performance, rather than just providing information when they commence their selling activities. Better visibility could assist the regulator to identify and act against non-compliant entities.

However, reporting requirements will need to be tailored to each exemption class to not burden smaller entities. Whereas more detailed performance reporting obligations could be imposed on larger exempt sellers, potentially with a requirement for them to advise on pricing levels to ensure any benefits the exempt seller is receiving are being passed on, given the noted industry practices that exploit customers' lack of access to retail competition to charge higher prices.

As barriers to embedded network customers accessing retail market offers exist, some embedded network operators face limited incentive or obligation to pass savings on to customers. While the exempt seller is able to charge tariffs up to the standing offer price for small customers this can result in an outcome where exempt sellers face an incentive to bargain with a retailer to obtain the best price at the parent connection point, but a weaker incentive to pass on any savings made at the parent connection point to embedded network customers. Enhanced reporting arrangements would alert the regulator to the extent of this issue, and if further amendments to exemption conditions are required. This information could





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also assist the regulator at the initial assessment phase, and result in the regulator only approving new embedded networks that are in the consumer's best interest.

Finally, we support the regulator considering how family violence protections recently introduced in the National Energy Retail Rules could be applied to exempt embedded network

customers. While the full extent of obligations on authorised retailers may be too prescriptive for smaller exempt parties, consideration of an amended, or principles-based, approach is supported.

We hope that this review will lead to improvements in the national embedded network framework. This is not to suggest that this workstream alone will provide all necessary improvements. We consider that other amendments will only further enhance arrangements for customers in each jurisdiction.

This is why the Division is pursuing other changes, such as discussing enhancements to the regulator's role when a consumer approaches them with an embedded networks related issue. Also, the creation of an information sheet tailored for South Australian embedded network customers, available across various platforms, could be an important amendment to improve information for customers so they are able to clearly understand the implications of being in an embedded network. The Division has provided correspondence with the regulator on these matters, and we hope that these discussions can continue in 2024 to enable other framework improvements.

The Division thanks the regulator for the work on this important matter. Should you have any questions in relation to this submission, please contact Mr Chris Leverington, Senior Policy Officer, Strategic Policy and Delivery Division, on [REDACTED]

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Vince Duffy'.

Vince Duffy
**DEPUTY CHIEF EXECUTIVE
DEPARTMENT FOR ENERGY AND MINING**

6/2 / 2024

