



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,

A handwritten signature in black ink, appearing to read "Cameron O'Reilly". The signature is fluid and cursive, with a large loop at the end of the last name.

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

Competitive neutrality in energy service provision

ERAA smart meter Working Paper 3

The collective voice of
electricity and gas retailers



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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.

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.

Third party and distributor sale of energy management services

ERAA smart meter Working Paper 5



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.

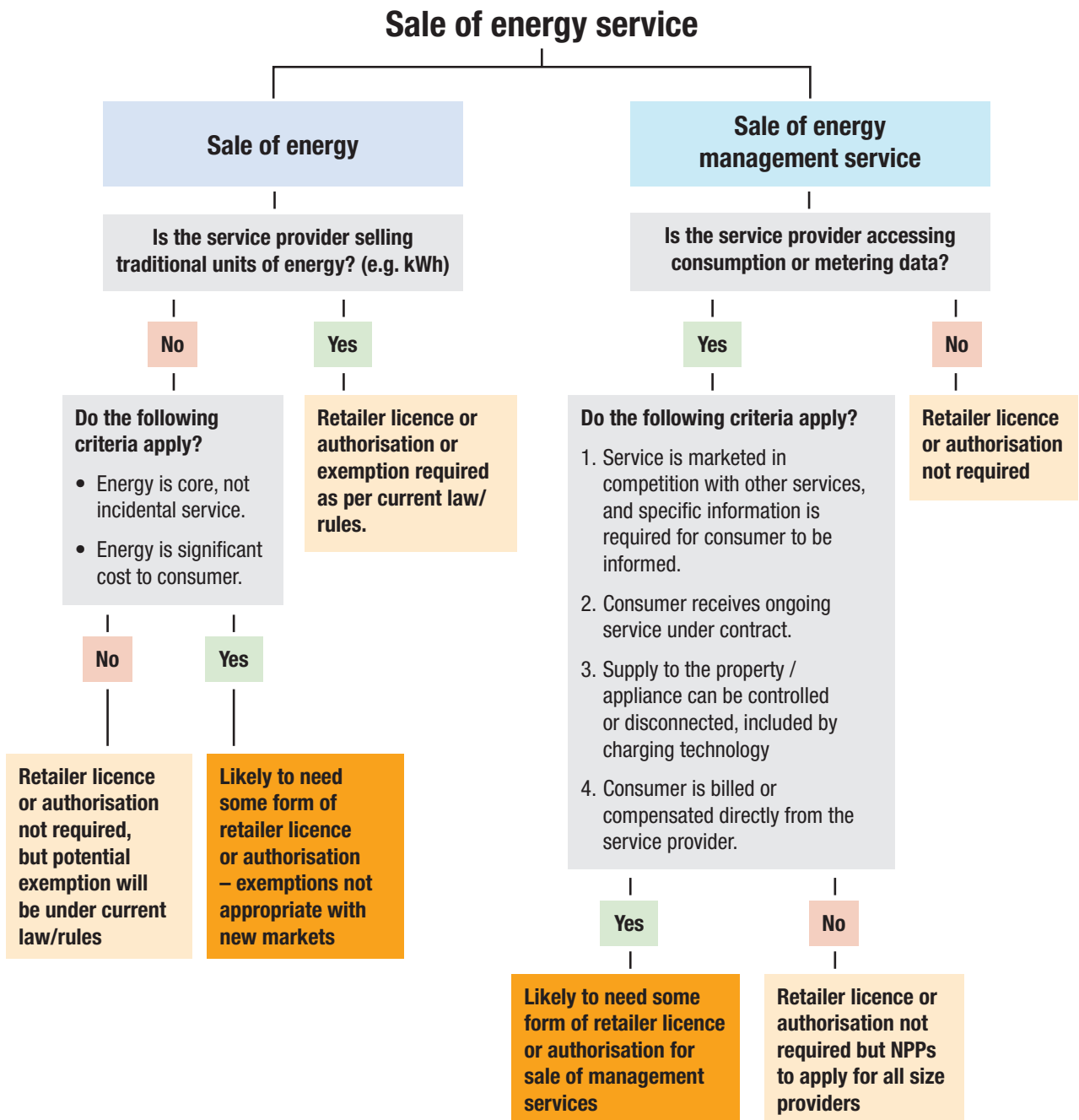


Figure 1: A proposed conceptual framework for new retail authorisations

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