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Submitted by email to: [aer inquiry@aer.gov.au](mailto:aer inquiry@aer.gov.au)

### **Regulating Innovative Energy Selling Business Models**

Thank you for the opportunity to provide a submission to the Australian Energy Regulator's (AER) Issues Paper on Regulating Innovative Energy Selling Business Models under the National Energy Retail Law.

Simply Energy would like to state upfront that our motivations in responding to the AER's Issues Paper are not centred on protecting our business model. As the AER is aware, Simply Energy Solutions has applied for an exemption and thus the additional regulation we advocate for in this submission will affect our business as much as any other non-grid energy supplier (NGES).

The other point that Simply Energy would like to make up front is that there is nothing particularly innovative about the suppliers that have been receiving exemptions despite language that is used that describes them as 'innovative energy suppliers'. Solar panels have now been a feature of the energy industry since the solar powered hot water industry became well established in the 1970s. The innovative aspect of these exempt sellers is the business model being used that assists in avoiding the energy regulations that should otherwise apply.

Simply Energy has advocated in the past for the AER to adopt a robust principle-based framework for considering exemption applications. We had advocated this to try and assist the AER in its thinking about these new evolving models and to offer the benefit of our experience in what is a rapidly evolving technology space. In our view, there was a high risk of over-focussing on the technology being used rather than focussing on genuine market failures. If this occurred, there was the potential for the AER to fall into the trap of having to amend its regulatory approach every time a new technology or business model appeared.

In a rare moment for the electricity industry, technology is rapidly changing and Simply Energy cannot see this change abating for at least another 5-10 years. The forces driving this change are changes in customer demand and the declining costs of new technologies. Future changes will continue to be driven by these forces but will likely become more sophisticated and innovative as smart meters are rolled out on a contestable basis across most of the National Electricity Market (NEM).

The framework the AER uses to assess exemptions must stand this test of time otherwise the AER will forever be on the back foot and having to play catch up with technology change.

#### **The potential for market failure**

In assessing applications for exemption, the AER needs to reflect upon the potential for market failure and whether that failure will lead to consumer detriment.

The market failure with these business models centres on clause 114(1)(b) of the National Energy Retail Law (NERL):

“exempt customers should, as far as practicable, be afforded the right to a choice of retailer in the same way as comparable retail customers in the same jurisdiction have that right”.

The potential for market failure rests on the length of the contract that customers of non-grid energy suppliers sign up to, the size of the early termination fee the customer must pay to exit that contract early, and whether these contract terms act as a barrier to exit and prevent the customer from having ‘the right to a choice of retailer in the same way as comparable retail customers’.

We do not have access to the full set of terms and conditions offered under non-grid energy supplier contracts. Our understanding comes from a review of the applications on the AER’s website.

The contract length and early termination fees of some of the non-grid energy suppliers that have received exemptions are set out in the following table.

Non-grid energy supplier	Contract length	Early termination fee
Demand Manager	5 to 15 years	Must buy out the balance of the contract
Solar Wholesalers	8 years commercial, 5 years residential	Must pay termination and removal charges
Applied Environmental Solutions	15 years	Must buy out the balance of the contract
REpower Shoalhaven	8 to 15 years	Must buy out the balance of the contract
Solar Financial Solutions	Up to 10 years	Must buy out the balance of the contract
Zero Cost	20 years	Must buy out the balance of the contract

In our view, the high cost of exiting a non-grid energy supplier contract during the term of that contract means that the customer is effectively prevented from having a choice of retailer. The cost of exiting a non-grid energy supplier contract is substantially higher than the early termination fees on a standard retail market contract and can amount to thousands of dollars.

So if grid delivered energy becomes cheaper than the non-grid energy supply, or some technological innovation makes some other form of non-grid delivered energy cheaper than the current non-grid energy supply, the customer will be excluded from accessing this cheaper alternative because of the high cost of exiting the current contract. In essence, the customer is monopolised by the non-grid energy supplier and must prefer that provider for their energy supply for the length of the contract.

The barriers to exiting these contracts will only increase as higher cost technologies, such as storage, enter the market and contract terms become longer. For example, the ‘Solar Plus Storage’ submission to the Issues Paper states that a 25 year contract length is necessary due to the cost of the equipment.

To be clear, we see the market failure as being the high cost of exit from these contracts. If a non-grid energy supplied customer did not need to buy out the remaining term of a contract upon exit, then we are not so sure there is a market failure. So it is not the business model or technology that the non-grid energy supplier is using that causes the market failure, rather it is the nature of the contract that has the potential to cause market failure.

This thinking is consistent with the thinking often applied to competition between authorised retailers where early termination fees are often cited as a barrier to exiting a market contract, reducing the incentive to switch retailers and thus is detrimental to customers being able to access better offers available in the market. For this reason, early termination fees are now much more heavily regulated than they have been in the past.

Long term contracts for non-grid delivered energy are potentially more of a problem for consumer choice than anything currently posed by grid-delivered energy. This raises significant customer protection issues in ensuring that consumers are able to access the energy supplies that meet their needs in the long term.

In our view, the AER should not focus on questions such as whether the supply is supplemental, who is the primary supplier and what the impact of de-energisation may be. Given the nature of the market failure, these are not the right questions and they will only result in the AER having to continually revise its approach in response to advances in technologies.

The key questions the AER should be focussed on are:

- (i) whether the nature of the contract being entered into by the customer results in a market failure,
- (ii) if so, does this market failure result in detrimental customer outcomes.

In Simply Energy's view, contracts that have high costs of exit have the potential to result in a market failure that could have detrimental impact on the customer because the customer is restricted from full participation in the competitive retail market. If the customer no longer likes their non-grid energy supplier and wants to change suppliers, the customer will find it very costly to do so.

### **What are the customer outcomes of this market failure?**

The question that then needs asking is whether this market failure leads to detrimental outcomes for the customer. In other words, is the customer any worse off by having to pay large early termination fees if they wish to exit the contract?

In our view, the potential exists for the customer to be much worse off and some of the potential detrimental impacts we consider that could occur are as follows:

- As noted above, if grid delivered energy becomes cheaper than the current non-grid energy supply, or some technological innovation makes some other form of non-grid delivered energy cheaper than the current non-grid energy supply, the customer will be excluded from accessing this cheaper alternative because of the high cost of exiting the current non-grid energy supply contract.
- If the customer falls into hardship, non-grid energy supply advocates argue that the customer can fall back onto the authorised retailer. This is true but it does not address the fact that the hardship customer will have a large outstanding debt to the non-grid energy supplier for the balance of the contract. The customer has no protection from the debt collection practices that the non-grid energy supplier uses to recover the outstanding value of the contract. If instead the non-grid energy supplier removes the equipment from the premises (rather than requiring payment of the remaining term of the contract), then the potential exists for the customer to lose the value of the contract they have already paid for.
- If the non-grid energy supply contract allows the non-grid energy supplier to vary the price contained within the term of the contract and the non-grid energy supplier increases the price, the customer must pay high exit fees on that contract to avoid the price increase.
- If the non-grid energy supplier incorrectly bills the customer and applies an over charge or undercharge, there are no requirements on the non-grid energy supplier to return the over charge and no limit on how far in arrears the non-grid energy supplier may claim an undercharge.

To avoid being worse off under these contracts, much relies on the customer being fully cognisant and understanding of the terms of the contract that they are entering into at the point of sale.

## Allocative efficiency requires genuinely technology neutral regulation

The Issues Paper states that regulation should be technology neutral. This is an important principle, as otherwise regulation will drive suboptimal outcomes that fail to meet the NERO. Regulation is not currently technology neutral, as grid-delivered energy is regulated differently from non-grid delivered energy.

Unless regulation is well designed (and currently with respect to these issues it is not) then consumers will be driven to certain choices due to regulatory settings rather than because those choices represent the best way of meeting the consumer's needs. This outcome fails to provide allocative efficiency and does not meet the NERO. For example, if grid-delivered energy continues to be heavily regulated and other energy supplies are not, then the non-grid delivered supplies will be chosen (for price reasons, for example) even when they are not the best way of meeting the consumer's needs for energy. This will result in an inefficient allocation of resources between grid-delivered and non-grid delivered energy.

This issue should not be misunderstood as being about competitive neutrality between businesses or business models. Additionally, discussion should not be swayed by emotive arguments that blur the facts.

For example, an advocate of non-grid delivered energy compared the issue about technology neutrality in the energy industry to competitive neutrality between wheelwrights and the car industry. This language casts those seeking technological neutrality in the energy industry in the role of advocates for protection of an outdated technology.

Grid-delivered energy is not an outdated technology. This is shown by the arguments of advocates of non-grid delivered energy who argue that non-grid delivered energy does not need to be subject to energy industry regulation because the customer can fall back on regulated grid-delivered energy. If grid-delivered energy is outdated, then why does their argument rely on it being available at the customer's site?

An appropriate use of the 'wheelwright' analogy to the energy industry would be to compare wheelwrights (the traditional industry making wooden wheels) with new-entrant wheel manufacturers, making similar wheels but using steel in place of wood (the new wheel technology).

Imagine that the traditional wooden wheel industry was subject to strong customer protections, such as the following:

- Wheelwrights must continue to supply wooden wheels to customers who are unable to pay, until strict processes for ceasing supply of wooden wheels have been followed.
- Wheelwrights must offer regulated payment options to customers who are unable to pay for the wooden wheels they have received.
- Customers who are unhappy with their wooden wheels can complain to a third party 'wooden wheel ombudsman', at the wheelwright's expense.
- Prices charged by wheelwrights for wooden wheels, and the terms and conditions of supply, are closely scrutinised by wooden wheel regulators, and some aspects of them are regulated.

All of these protections add cost to the wooden wheel industry.

Now imagine that the new-entrant steel wheel industry argued that there is no need to apply the wooden wheel customer protections to the steel wheel industry because customers who had trouble with their steel wheel supplier could fall back on a regulated wooden wheel supplier.

If this argument was accepted then allocative efficiency would not be achieved, as there would be instances where steel wheels would be supplied in place of wooden wheels, despite the wooden wheels being a better

solution. Steel wheels would be chosen in these instances because they are not encumbered by the additional costs of the wooden wheel consumer protections, and are thus able to out-compete the wooden wheels.

This analogy applies well to the energy industry: wheels are wheels whether they are made of wood or steel, and energy is energy whether it is delivered by the grid or comes from a non-grid supply. In both cases regulation should apply equally to all supplies, no matter what technology is used.

### **Issues for stakeholder consideration raised by the AER:**

In this section, we have set out our responses to the AER's questions in the Paper.

*What difference, if any, should storage and/or other emerging technologies have on how the AER proposes to regulate SPPA and other alternative energy selling models?*

Storage and other emerging technologies or different business models should not make any difference to how the AER approaches regulation of non-grid energy suppliers.

We would prefer the AER took a principle-based approach to deciding how to regulate this emerging area and in our view should focus on whether there is a market failure that could result in detrimental outcomes for customers. As we have explained above, we believe there is a market failure that could have quite detrimental outcomes for the customer that the customer may not realise when they contract with the provider.

*What are stakeholders' views on the AER's proposed options? Are there other options to which the AER should have regard?*

In our view, full authorisation (Option 1) is not required as authorisation is a regulatory solution the costs of which far outweigh the benefits it provides. Authorisation means certification and accreditation by the market operator as well as other wholesale and network obligations that seem unnecessary.

Option 2 (exemption with robust conditions) is the superior option for addressing the identified market failure in the short term and given the options the AER has available to it under the NERL.

We note that Simply Energy's preferred solution is for these businesses to be subject to a form of 'small-scale authorisation'. This would be a scaled down retailer authorisation that would provide the AER with the powers it needs to monitor and enforce the customer protection framework on those selling energy through non-grid delivered energy sources.

We know that this facility is not available to the AER but we will be raising it with the Energy Council through its concurrent review.

*In relation to Option 2 (exemption, rather than authorisation), what, if any, conditions should be placed on an individual exemption for an alternative energy seller?*

The conditions that should apply to an exemption should be guided by the nature of the market failure and should attempt to address that failure through the least cost option.

In our view, the exemption conditions should include at least the following list and centre on information provision upfront to the customer, how disputes between the supplier and customer are handled and payment difficulties.

- The requirement to obtain and record the customer's explicit informed consent (Division 5 of the NERL)
- A requirement to provide or offer interpreter services (Rule 55 of the NERR)
- Requirements around information provision to small customers (Subdivision 2 of the NERR)
- Requirements in regard to energy marketing activities (Subdivision 3 of the NERR)
- Small customer complaint and dispute resolution information (Rule 50 of the NERR)
- Termination of contract requirements (Rule 49 and 49A of the NERR)
- Cooling off period and right of withdrawal (Rule 47 of the NERR)
- Tariffs and charges (Rule 46 of the NERR)
- Security deposit requirements if the supplier requires this (Division 6 of the NERR)
- Some form of hardship policy or at least a requirement of a statement on how the supplier will address situations where the customer falls into hardship and can no longer keep up payments
- Overcharging and undercharging requirements (Rules 30 and 31 of the NERR)
- Billing disputes (Rule 29 of the NERR)
- Estimation as basis for bills (Rule 21 of NERR)
- Ombudsman scheme membership
- Procedures to manage removal of the non-grid energy supply (similar to the de-energisation procedures for grid-delivered energy), including overdue payment warnings, notice periods, supply withdrawal warning, and collection attempts

We also support many of the proposed conditions that the AER has set out in the Issues Paper. We set out our response to each obligation in the table set out in the appendix to this submission.

*Should the AER include a 'trigger point' for review of individual cases if it proceeds with Option 2?*

As a general rule, we do not like trigger points or thresholds as they create incentives to 'game' that trigger point or threshold to avoid regulation.

Our understanding of the issue from discussions at the forum is that the AER's primary concern is the resourcing of the compliance and enforcement effort given the very large number of non-grid suppliers entering the market.

We think it is important to distinguish this issue from whether or not the conditions attaching to an exemption should apply. It is the individual customer that is impacted by the market failure and thus the conditions should apply regardless of how many customers the non-grid supplier is supplying to.

However, we recognise the size of the compliance and enforcement task the AER may be inheriting by imposing the range of conditions we suggest.

Rather than adopt a trigger point, we think that a short term solution may be for these non-grid suppliers to provide a scaled down version of the key performance indicators and compliance reporting requirements to provide the AER with intelligence on what is happening in the market. With this information, the question of how the compliance and enforcement task is resourced could be revisited in say 3 years once there is a better understanding of how big the task is.

## One final issue

There is one final issue that we struggle with and this concerns how transfers of premises works. If the customer moves out of the house for which they have contracted for off-grid delivered energy, are they

required to buy out the remaining term of the contract or is the new occupier of the premises expected to take up the lease on the infrastructure?

In either case there are questions that we have. First, if the customer is expected to pay out the balance of the contract, what happens to the infrastructure on the house that they have paid for? Second, if the new resident is expected to take up the lease, then this raises all sorts of questions about deemed customer arrangements that we are unclear about.

### Conclusion

The market is in a perverse situation. Grid delivered electricity is so much more reliable than other potential supplies that it is able to meet a consumer's needs with a certainty that other sources of supply cannot match. As a result it attracts a high level of regulation that is not currently applied to other sources of supply. This makes grid-delivered electricity less competitive than comparable-cost alternative sources, reducing allocative efficiency due to overinvestment in non-grid delivered energy.

This also reduces the scale of grid-delivered energy and puts pressure on its ability to cost effectively maintain its level of reliability. If this approach to regulation continues then it will have the result of 'picking winners' with respect to technology (which it states that it does not want to do), and the winners will be everything except grid-delivered electricity, the most reliable source.

If you have any questions concerning this submission, please contact either myself on (03) 8807 1132 or James Barton, Regulatory Policy Manager on (03) 8807 1171.

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## Response to the conditions discussed in Attachment A of the Issues Paper

Condition	Support or not	Reason
Only sell energy under the business model exempted	Yes	The business that they are conducting is the business that has received the exemption. Any change should require a further approval process so that NGES's don't become authorised retailers by stealth.
Obtain EIC	Yes	As there are significant barriers to exiting these contracts, obtaining and retaining the customer's explicit informed consent should be required
Sell energy that is metered	Yes and metering should comply with the required standard	Otherwise the customer does not know whether the customer is getting a good deal or not; Metered energy is important for accurate billing
Clear, accurate billing information	Yes	The customer should know that the bill they have is theirs and have access to sufficient information on the bill for them to recognise the bill may be incorrect
Report on customer service and complaints etc	Yes	We believe this important to keep the AER and policy makers in general informed on the performance of the suppliers in this sector. We prefer this to 'trigger points' and the information gathered will inform future policy making.
Compliance reporting	Yes	We believe this important to keep the AER and policy makers in general informed on the performance of the suppliers in this sector. We prefer this to 'trigger points' and the information gathered will inform future policy making.
Reporting against the trigger point	Yes although this should be an annual requirement to notify the AER of the seller's progress against the trigger.	We have concerns that non-grid energy sellers may overlook this obligation if it is not a regular reporting requirement
Obligation to supply	Limited obligation could be appropriate in some circumstances	



Condition	Support or not	Reason
Information provision	Yes	Given the nature of the contract, there are minimum information requirements that should be in place so that the customer understands the consequences of the contract they are entering into and are aware of their rights and the duties of the supplier during the contract
Billing and payment arrangements	Yes	
Estimation as basis for bills	Yes	There should be requirements in place that impose minimum conditions on the suppliers where a meter read fails or some other reason forces the supplier to bill on an estimate.
Pay-by date	Yes	
Receipt	Yes	Should be minimum business practice
Pricing – not charge higher than the standing offer rate	No	This is price regulation which Simply Energy does not support as a matter of principle; Administratively costly to implement given that standing offer prices are no longer regulated
Pricing – other conditions	Yes	
Undercharging and overcharging	Yes	
Payment difficult and disconnection	Yes	A payment plan process that sits somewhere in between nothing and the requirements that must be met by authorised retailers, ie say a requirement to offer two payment plans, would offer the customer some degree of flexibility if they find themselves in hardship NGES's should be required to follow a process prior to disconnection to give them notice that disconnection could occur and that gives the customer time to act upon the situation.
When disconnection and cessation of supply is prohibited	Limited obligation could be appropriate in some circumstances	
Reconnection of supply	Yes	

Condition	Support or not	Reason
Concessions and rebates	Unsure	The concession frameworks are complicated and in the instance they could be provided by the FRMP. However, some concessions provide for a % off the bill. So if the customer is taking less supply from their FRMP, then they will forgo at least some of the concession unless the NGES is also required to provide the balance of the concession
Choice of retailer	Yes	Important for the customer to be able to access better offers as and when they become available
Contact details	Yes	Should be minimum business practice
Dispute resolution	Yes	
Life support customers	Unsure but unlikely	We feel that a life support customer can fall back on the grid delivered supply. Our only query is the potential for bill shock for these customers given they will likely fall back onto a standard offer
Continuity of supply	Yes	The potential for this to happen is a significant issue should it occur and is a quasi-ROLR event. We are concerned with what this means for the customer, the value they have already invested in the infrastructure, the impact of termination fees and potential for bill shock if these customers must fall back on the grid. There are also potential issues for retailers in managing customers' expectations and complaints.
Termination of agreement	Yes	
Maintaining records	Yes	