

22 November 2013

Jacqui Thorpe
Acting General Manager,
Retail Markets Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email: AERInquiry@aer.gov.au

Dear Ms Thorpe

RE: ALTERNATIVE ENERGY SELLERS – ISSUES PAPER

ERM Power welcomes the opportunity to respond to the AER's Issues Paper *Regulation of alternative energy sellers under the National Energy Retail Law*. We believe that the lack of a regulatory approach for alternative energy sellers (that is, those who do not fit the 'typical' model for energy retailers or exempt sellers) is a serious deficiency in the NECF *National Energy Retail Law* and *National Energy Retail Rules* (NECF). This deficiency needs to be rectified and we are pleased to see the AER turn its attention to this important issue.

However, we do not believe that the approach as proposed by the AER goes far enough. We do not agree with the AER's assessment that the existing authorisation and exemption framework is suitable for the regulation of these sellers. There are assumptions underpinning the AER's approach that will be challenged in coming years, most notably by the concept of multiple financially responsible market participants (FRMPs) that the AEMC has put forward¹ and that AEMO is currently working on to develop a rule change. In our view NECF itself must change if we are to maintain its consumer protection standards and provide for competitive neutrality in an objective way.

About ERM Power Limited

ERM Power Limited is an energy company listed on the ASX that operates electricity sales, generation, and gas exploration and production businesses across Australia. Our energy sales business, ERM Power Retail, is licensed to sell electricity in all Australian states, the Australian Capital Territory and the Northern Territory, and has grown organically to become the fourth largest seller of electricity in the National Electricity Market by load.

ERM Power Retail (branded as ERM Business Energy) specialises in providing electricity to business and government customers. We have accrued over 13 per cent of the large Commercial and Industrial (C&I) customer market, and this year we started to offer electricity to the Small to Medium Enterprise (SME) segment of the market.

¹ See AEMC (2012), *Energy market arrangements for electric and natural gas vehicles*, Final Advice, 11 December 2012.

A Utility Market Intelligence survey by independent research company NTF Group found ERM Power Retail has provided the greatest business customer satisfaction for two years in a row, with the 2012 result setting a new record for the survey with a customer satisfaction rate of 93 per cent.

Suggested policy objectives for consumer protections

In ERM Power Retail's view, the most important policy objectives to be met in the development of an appropriate regulatory framework for alternative sellers are:

- maintaining appropriate standards of consumer protection for all consumers;
- maintaining competitive neutrality between competitors; and
- future-proofing NECF as objectively as possible to avoid frequent changes or excessive tailoring of exemptions to each business model as it arises.

The AER has taken a different approach, instead focussing on the essential nature of electricity (which can be seen as a proxy for the first dot point), and it has not specifically accounted for the other two points. The AER's approach in its Issues Paper restates the existing practical criteria for requiring a retailer authorisation (sale of energy, linked to the essential nature of service) and indicates that each new individual exemption application for alternative sellers (defined as generally those who sell 'add on' services to the existing retail service) can be addressed in a bespoke fashion as required.

Focussing on what is essential is an interesting philosophical notion, but we question whether the issue is possible to answer in an objective and practical sense. It is unlikely that the AER meant to open this up for debate but it should be recognised that if we are to focus on what is essential we need to ask ourselves as a policy community what this actually means. Historically we have not had to grapple with the question of what aspect of energy provision is actually essential;² however, the landscape is changing: the introduction of multiple FRMPs at a premises means that we need to start from first principles if we are to meet the policy criteria above.

The second string to the AER's proposed approach – that of managing exemptions through the existing framework but with recognition that bespoke approaches to regulation are required – avoids the problem of managing multiple FRMPs for now but shifts it into the future. We do not think this is sufficiently objective or sustainable. It also does not account for other categories of service provider, such as energy management services that access data and may control load.

In our view NECF itself needs to change, ideally to redefine what being a retailer means (specifically regarding what is being sold), and to perhaps create a different form of authorisation for some categories of service provider. NECF specifically needs to be able to categorise and value a service on its own terms, rather than by reference to the other services at the premises.

This is discussed in detail in the following pages.

² Although perhaps we should: energy is essential in a general ethical sense and as a rhetorical device, but there must be exceptions to this already given that disconnections are allowed, and that what is essential for one premises is not essential for another, such as medical cooling and gas supply.

The scope of the Issues Paper is too narrow

It is disappointing that NECF has only just been implemented in some states (and is apparently still months and maybe years away in other key states) and yet we can say without doubt that it is already out of date.

The substance of the law and rules under NECF was developed over several years, commencing almost a decade ago. NECF was based on regulatory frameworks that only contemplated retailers and distributors requiring regulation, and NECF itself has perpetuated this approach. As noted by the AER an exemptions framework was put in place, but this was created to manage the exceptions to the usual retailer business model, such as embedded networks providing energy to caravan park users. These business models required an exemptions framework because there was no retailer as commonly understood, and yet consumers were being supplied energy.

The new business models proposed in the past couple of years are fundamentally different from retailers, distributors and exempt sellers as we have historically known them, and as reflected in NECF. These alternative sellers propose to supply energy to consumers where a retailer is already in place, and where the alternative seller is potentially competing with the existing retailer. This includes a suite of new services being offered to customers as energy management services, where the customer's data is being accessed, and perhaps where load is controlled by the service provider. The lines between distributors and retailers are now blurred with the provision of these services, which is itself an issue before we even contemplate third party (alternative) service providers.

There is further complexity which also requires consideration, where alternative sellers may not even consider themselves as selling energy, which then raises the question of whether NECF can apply in any way. Some alternative sellers have stated that they are not selling electricity but something else, and so NECF does not apply: for example during the AEMC's electric vehicle consultation in 2012³ we heard an electric vehicle charging company state that it was not selling electricity but kilometres and so did not have to be subject to NECF. We note that the AER has said that electric vehicle charging *is* the sale of energy in its paper (see p. 11), but we also note that this issue was unclear for much of last year. We also believe that we need a framework to apply to these new situations rather than a bespoke regulatory ruling on every business model that arises.

In ERM Power Retail's view the questions that must be answered to meet the policy objectives are:

- what precisely should be regulated by NECF; and
- how we can capture different business model definitions in an objective sense.

The AER's paper has commenced this line of thought but has limited its consideration of alternative sellers to questions of whether the energy being sold is essential for the premises or whether they are selling energy in a secondary way (in that there is already a primary or 'typical' retailer providing the essential service). The paper considers the old world with minor allowances for new service providers rather considering the real definitional issues, the matter of energy management services and how NECF can stand up to the policy changes we know are on the immediate horizon. The

³ See footnote 1 for reference.

limited scope of the paper therefore means that the issues can then be answered with the existing authorisations and exemptions framework.

In our view this is not appropriate. In particular, the exemptions framework was not developed to cope with an influx of new energy service providers competing with retailers, and we will find over time that it is not fit for purpose. The existing authorisation framework may also not be appropriate for providers of services that are like retailers but not entirely so.

This is clearly not an easy exercise, but putting off the inevitable need to reassess NECF and its ability to reflect the regulatory needs of the existing and future market will not serve anyone, and particularly not consumers or the AER.

There needs to be a more comprehensive assessment of definitions

As mentioned above, the AEMC's 2012 electric vehicles consultation opened up an entirely new concept for the NEM: that of multiple FRMPs at a premises. This is now being developed by AEMO for a potential rule change for 2014-15,⁴ and multiple FRMPs (or as this issue is now called by AEMO, multiple trading relationships) may be in operation by 2016.

While raised via a consultation on electric vehicles, the multiple FRMP model is not limited to electric vehicles. A FRMP can sell electricity for any part of a customer's load and is only limited by practical considerations about what customers will accept and available data streams for any one premises.

For example, the multiple FRMP model provides (in theory) for a household to have one FRMP selling an air-conditioning service, another selling an electric vehicle charging service, another servicing the electric hot water and another billing the customer for general household lighting. The 'typical' retailer as we know retailers in our current model might just cover residual use. In this case, who is the primary retailer? What part of the supply is essential? It might be argued that any of these services are essential. Who gets to disconnect the property when the bills are unpaid and how are the inevitable issues such as complaints management (including access to Ombudsman schemes) and compensation to other services providers managed when a disconnection occurs?⁵

Further, what happens when these sellers consider themselves as selling something other than energy? The electric vehicle example of selling kilometres is not unprecedented or unrealistic: we already know that some retailers sell hot water as a product. Our hypothetical household's air-conditioning service might include an air-conditioner and the sale of cold air, the electric vehicle charging company is selling kilometres and the lighting service provider is selling light.

⁴ AEMO has commenced work on the required market design, for a detailed design to go to the AEMC by mid-2014. The AEMC's timeframe from there to consult on the rule change is not clear but the industry has been advised that 2016 is the likely date for multiple FRMPs to be in the marketplace.

⁵ We note that AEMO aims to address the technical limitations of disconnections as far as possible in its model. AEMO has also said it is considering engaging an external party to advise on the customer protections issues to go into the rule change proposal. This should be brought into the AER's process.

The AER's proposal does not appear to address or manage any of these issues in an objective sense. For example, we note the AER's following statements (pp. 13-14):

We consider that a retailer authorisation is generally necessary when:

- an alternative energy seller is the sole supplier of gas or electricity at a premises
- the alternative energy seller prohibits the customer from entering into a contract with another retailer, or requires the customer to enter into a contract with a specified retailer
- the alternative energy seller is registered with AEMO in the wholesale market for the particular fuel source, and is the financially responsible retailer for the particular premises.

Even though the alternative energy seller is not operating under a 'typical' retailer model in these situations a retailer authorisation will generally be necessary as the seller is taking on the role of an energy retailer, particularly to small residential customers.

In these circumstances energy is being provided as an essential service, as the alternative energy seller is supplying all or most of the energy consumption needs of the premises. This is consistent with the principle that all customers should have access to a reliable supply of energy.

The criteria are circular: the first dot point basically defines a retailer as we currently know it, as do the second and third points to some degree. Clearly if a seller is 'taking on the role of an energy retailer' (as mentioned in the AER's commentary) it is not an 'alternative seller' but an energy retailer and so it needs a NECF authorisation. We are perhaps missing the nuances in the AER's logic but we consider this to be a reflection of the lack of explanation in the Issues Paper.

It is also not entirely clear whether the dot points above are separated by 'or' or 'and'; that is, do all criteria need to be met or are they alternative scenarios? If all conditions need to be met, these criteria are clearly too limited.

If we instead assume the dot points above are alternatives (which is ERM Power Retail's assumption), the third dot point evolves the concept of an authorisation by providing for the future need for competitive neutrality across FRMPs selling to one premises. This is a welcome outcome, at least in a general sense.

However, the AER's commentary under these dot points is then concerning as it seems to only contemplate a situation where alternative seller (which we again note is 'taking on the role of an energy retailer') is 'supplying all or most of the energy consumption needs of the premises', where 'energy is being provided as an essential service'. As noted above, this is too narrow a focus: future energy service providers are likely to be much harder to categorise in this way.

Regarding exemptions, the AER goes on to say (pp. 14-15):

An exemption might be appropriate, where the alternative energy seller is:

- providing an 'add on' service to the customer – for example, where the customer can buy energy from a retailer of its choice

- providing a bundled contract for a service which includes the sale of energy, but where the sale of energy is a small or insignificant component of that contract.

If the seller is exempted, the customer:

- retains their right to buy energy from an (sic) retailer, and to choose its authorised retailer
- can access the full suite of *Retail Law* protections through its relationship with the retailer
- is protected by the AER's RoLR scheme if the retailer fails.

These statements are similarly limited to a future where there is clarity about what is primary and what is an 'add on', and also assumes there is a retailer at the site under the current understanding of what that means (a 'typical' retailer, to use the AER's terminology). The use of the word 'alternative' is also a challenge here as the service provider is not acting as an alternative to a retailer but as a supplementary service provider.

As a final but important point, we note that AEMO's current work on multiple FRMPs/trading relationships only contemplates the concept of a primary retailer in limited circumstances.

A proposal to future-proof NECF

It is possible that the AER's proposal could manage the issues for the immediate future (putting aside existing definitional issues and that it does not address energy management services at all), but the moment an alternative seller model comes up that does not sit unambiguously on one side of the binary divide between essential/non-essential consumer use, or primary/add on services, there will be a problem. We have already seen NECF take a decade to come to life and be implemented: will there be time to respond as required to the likely outcomes of the multiple FRMP model?

ERM Power Retail believes that more comprehensive analysis is required, and outcomes are likely to require fundamental changes to NECF through SCER and AEMC. We should not be defining future service providers as alternatives in the way the AER has proposed: not only are there semantic difficulties but the language (and the policy proposed) inherently presupposes to value a service by the *other* services at the premises, rather than on its own terms.

Energy retailers have already proposed a model of managing these issues, as provided in submissions to the AEMC in 2012 and in the Energy Retailers Association of Australia's (ERAA) 2012 paper *Third party and distributor sale of energy management services: ERAA smart meter Working Paper 5*. We have modified the ERAA's model presented in this paper in Figure 1 on the following page to clarify the paths to authorisations rather than exemptions, but the concepts are the same.

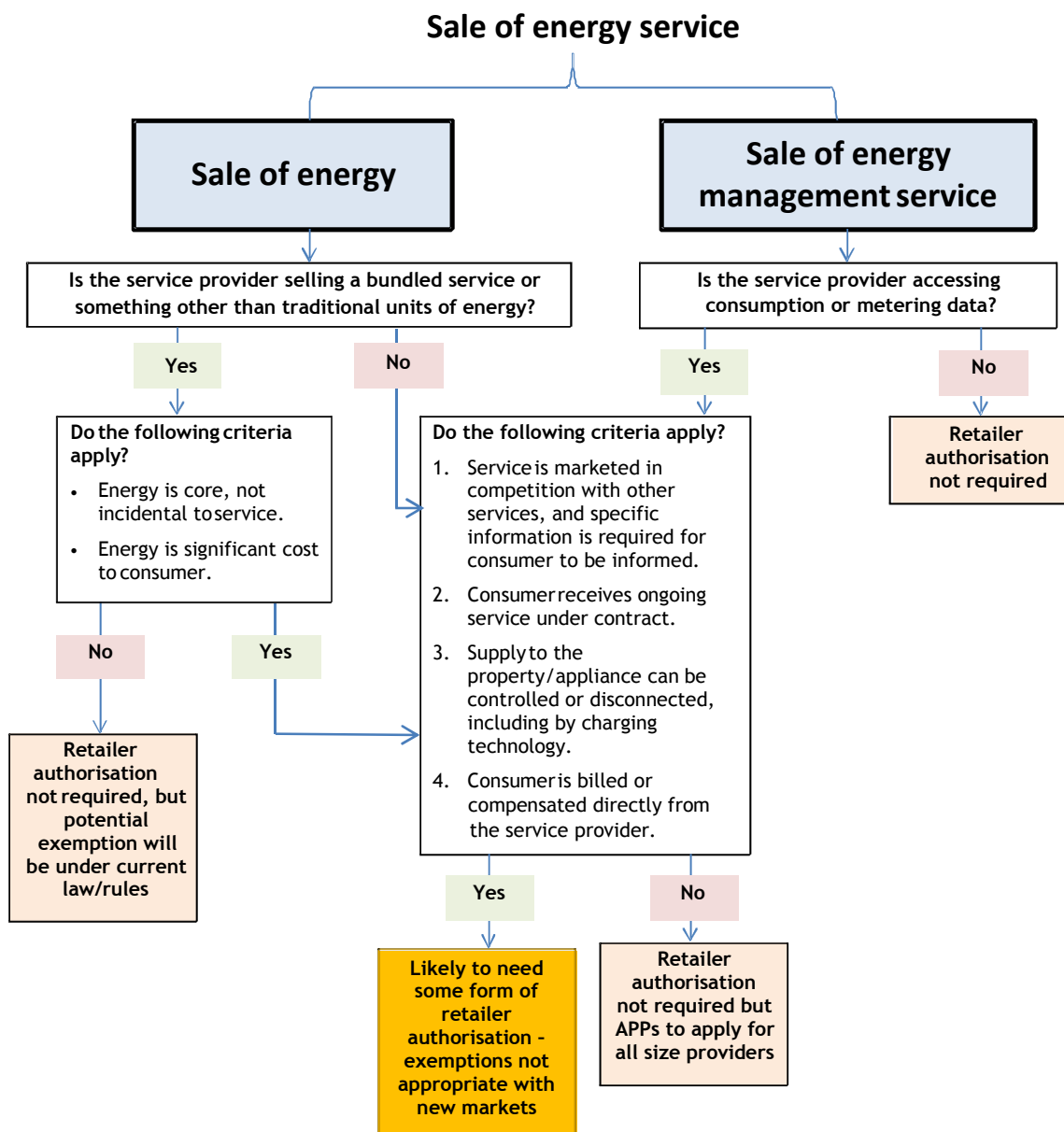
The ERAA has proposed that the NECF concept of 'sale of energy' should be redefined as sale of *energy services*, which includes retailing energy and energy management services. The proposal contemplates the range of different service models, from sellers of energy/something else, to the sale of energy management services. It does not go into what is essential or not but instead accepts the premise of NECF that protections under certain circumstances are warranted and then goes to the heart of what NECF was primarily created for: regulating marketing/consent to contracts, billing,

and disconnections. It addresses whether energy is being sold, and considers whether an alternative seller (and we note that this includes distributors, appropriately ring-fenced) will have access to a customer’s consumption data, which raises privacy concerns at the very least. Complaints handling is not addressed in Figure 1 but also requires consideration.

Importantly, this model does not depend on how many other retailers are at a premises and what their role is, but looks at the service being proposed to assess it on its own terms. This is a fundamental difference from the AER’s approach in its Issues Paper.

Figure 1: A proposed conceptual framework for new retail authorisations

Source: Modified from ERAA (2012) *Third party and distributor sale of energy management services: ERAA smart meter Working Paper 5*



In summary, we believe that the AER should consider a wider range of services than those in its Issues Paper, and that it should provide a more comprehensive understanding (and avoidance) of the definitional ambiguities in place now and in the likely future. This needs to start now. We believe that any assessment of the required regulatory framework for alternative sellers should start from the idea that the regulatory criteria that were behind NECF should be applied in a competitively neutral way to any service provider. This is likely to require a new view of authorisations and authorisation types rather than a dependence on exemptions.

The modified ERAA proposal above is not the only way of thinking about the issues, and it does not provide all the answers. However, it at least commences the process of looking at all the issues in the one place and it avoids locking into existing definitional ambiguities about what is and is not essential (which will only be amplified in the multiple FRMP future) or what is a 'typical' retailer (a term that will also only become more challenging over time).

We note that the AER is considering holding a public stakeholder forum for interested stakeholders; please note that ERM Power Retail is interested in attending the forum.

If you have any queries about this submission please feel free to call me on the number below.

Yours sincerely,

[signed]

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