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30 April 2025

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# Draft decision – Review of the AER exemptions framework for embedded networks

Endeavour Energy appreciates the opportunity to provide this response to the <u>AER's draft amendments to</u> <u>its Network Exemptions Guideline and Retail Exempt Selling Guideline</u>. We note that the updates are intended to increase transparency to better support AER compliance monitoring and extending some additional consumer protections to embedded network customers. Key changes include:

- closing the deemed network and seller exemption classes for future residential and small business embedded networks;
- exempt networks and sellers to notify the AER of updated contact details of their authorised representative within 20 business days;
- exempt residential networks to report their customer numbers annually to the AER;
- exempt sellers to provide customers at least five business days notice of a tariff variation and display prices on their websites or communal area; and
- exempt sellers to develop a family violence policy that complies guideline requirements.

#### We are supportive of the recommended changes

We are supportive of reducing fundamental information gaps that currently exist. We consider that other industry stakeholders, including peer Distribution Network Service Providers (DNSPs), would value additional transparency that could be facilitated by the AER, particularly in relation to the following:

- contact details of exempt parties and reported customer numbers, which could be published on the AER's website; and
- the inclusion of pricing disclosures and assistance for customers affected by family violence, which could align more closely with protections afforded to grid connected customers. Improved pricing visibility would better enable customers to compare the competitiveness of their rates and, accordingly, consolidating them on the AER website would better facilitate comparison to onmarket offers and assist with compliance monitoring.

We note, however, that not all embedded network customers will benefit from this transparency given wiring configurations and metering arrangements will continue to prevent many from accessing better retail prices. In view of this, we have detailed below additional aspects that may warrant further AER consideration.

#### There is more that can be done to improve outcomes for embedded network customers

The AER's draft decision acknowledges that the current framework does not provide embedded network customers the same level of consumer protections and choice as grid connected customers. It identifies similar regulatory gaps as had been previously identified in reviews conducted by the AEMC and NSW



Government,<sup>1</sup> noting however that many of these gaps require regulatory amendments from jurisdictional governments to address.

We appreciate that views differ on whether these gaps are best addressed through the AEMC's recommended amendments, by jurisdictional government reforms and/or via the AER's embedded network guidelines. However, while these gaps persist, we are concerned that embedded network customers will continue to be exposed to greater risks and poorer price and service outcomes than grid-connected customers.

Accordingly, we would strongly encourage the AER to consider further amendments within its remit to strengthen the protections offered to embedded network customers. In particular, we recommend the guidelines include conditions to achieve the following outcomes:

- Enhance transparency: We support improved visibility of customer numbers and the contact details of exempt parties. We recommend:
  - extending the customer number reporting requirement to ND1, ND2 and NR1 categories on the basis it will be unlikely to be administratively onerous or costly;
  - introducing mandatory reporting on key service performance outcomes and compliance trends within embedded networks; and
  - requiring information be provided to the AER on how bulk pricing benefits and network cost savings are accrued and passed through to embedded network customers and on how the benefits of on-site CER are distributed between the embedded network operator (ENO) and individual customers.
- **Promote customer interests:** We recommend the application process includes a requirement for exempt networks to provide evidence that demonstrates the net benefit it expects to deliver to customers relative to a standard connection arrangement.
- Improve outage arrangements (which will further promote customer interests and enhance transparency): We frequently encounter embedded network customers who have not received a notification from their ENO informing them of planned interruptions. We are incurring significant costs in cancelling and rescheduling these works as a result. We therefore recommend that:
  - ENOs be required to provide DNSPs with confirmation that planned interruption notification has been issued;

<sup>&</sup>lt;sup>1</sup> By way of background, in its June 2019 market review, *Updating the regulatory frameworks for embedded networks*, the AEMC observed, "the current regulatory arrangements for embedded electricity networks are no longer fit for purpose, resulting in some customers not being able to access competitive prices or important consumer protections. There are also insufficient monitoring and enforcement powers, leading to a lack of clarity that embedded network operators are meeting their obligations as suppliers of an essential service. While some embedded networks are providing benefits to energy consumers that they may not receive in a standard supply arrangement, often they do not". Key areas of divergence include service performance outcomes, pricing and consumer protections, particularly between the National Energy Customer Framework which applies to on-market customers and the AER's exemption framework.

The AEMC subsequently developed a suite of changes designed to improve customer protections and access to retail market competition which, unfortunately, have not been actioned. As a result, embedded network customers continue to be exposed to greater risks and poorer outcomes than grid-connected customers.

In response to these ongoing challenges, the NSW Government conducted an inquiry into embedded network service outcomes in NSW which reached similar conclusions to the AEMC. Following this review, the NSW Government released an <u>Embedded Network</u> <u>Action Plan</u> committing to a range of measures to provide more equitable outcomes for embedded network customers. This plan included advocating for amendments to the AER's Retail Exempt Selling Guideline to enhance the national approval process for new retailer and network exemptions to ensure any new embedded networks are in the long-term interests of consumers.

- o DNSPs be allowed to recover costs incurred from non-compliant ENOs; and
- a mechanism be established requiring ENO notification breaches to be reported to the AER.
- Clarify life support obligations: Life support protections within embedded networks differ from requirements of the National Energy Customer Framework in that they apply following medical confirmation, rather than when the customer makes known their life support needs. This creates confusion for ENOs and their customers around how and when protections apply where a DNSP is notified of life support needs instead of their respective exempt network or seller. This confusion could be avoided if the guidelines explicitly clarified the flow of life support information between parties and the risk to customers of not being afforded protections where they provide notice outside of the prescribed process, including where they inform the DNSP of life support-related needs.

We consider that the exemption guidelines present the most practical mechanism to address the discrepancies outlined above, particularly in light of the current pause on efforts to harmonise the protection frameworks across jurisdictions, and encourage the AER to consider opportunities to make further amendments to improve protections and outcomes for embedded network customers.

**Appendix A** sets out our more detailed views regarding the AER's draft decision and suggests measures that could be taken to address a specific operational challenge that is emerging as a result of gaps between the NECF and exemption frameworks.

To discuss any aspect of our submission further, please contact Patrick Duffy, Manager Regulatory Transformation and Policy, at the second sec

Yours sincerely

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# Appendix A – Detailed response

# To address poor price and service outcomes experienced by embedded network customers, stronger reporting and pricing protections are required

The AER's Issues Paper contemplated making significant changes to the exemption guidelines to stem the growth of residential embedded networks and reduce the risk of customer harms. These included:

- closing the NR2 exemption class for residential networks;
- placing firmer obligations on applicants to demonstrate customer benefits;
- requiring the AER to assess applications on a case-by-case basis; and
- introducing compliance and performance reporting obligations.

We understand that the AER has refrained from implementing these reforms as it considers the risk of consumer harm is not sufficiently severe or widespread to warrant the interventions. We appreciate the AER's focus has been to mitigate potential customer harms, while keeping the conditions in the guidelines simple and manageable, to enable exempt networks and sellers to comply.

However, we respectfully submit that the AER's findings are at odds with the 'real world' experiences and outcomes of many embedded network customers; consequently, we are concerned the draft amendments may not in practice optimally balance consumer protections and proportionate regulation. In addition, the observation that embedded network customers are not typically experiencing worse pricing outcomes than grid-connected customers is at odds with findings arising in other similar reviews. By way of illustration:

- the AEMC noted examples where on-sellers had no incentive to obtain the best market offer, and consequently, that customers ultimately paid more than they would on a competitive market offer;<sup>2</sup>
- the NSW Committee of Law and Safety Inquiry into embedded networks heard evidence, including from customers experiencing much higher charges after moving from standard supply to an embedded network, indicating embedded network consumers generally experience high bills and many do not receive the benefit of bulk savings.<sup>3</sup> The Committee's final report observed that some residential customers in embedded networks faced unjustifiably high energy costs and attributed these poorer outcomes to the challenges in accessing on-market offers, noting that "the charges for embedded network services it examined were unreasonably high and has serious concerns about the continuation of this practice by some embedded network service providers"<sup>4</sup> and that "Embedded network customers are also limited from switching service providers and may be subject to extremely onerous contract provisions. This limits customers' ability to access market competition and, in the Committee's view, is likely the root cause of unreasonably high costs",<sup>5</sup> and
  - NSW's Independent Pricing and Regulatory Tribunal (IPART)'s review of embedded network pricing protections highlighted poor pricing outcomes. Specifically, IPART's final report observed, "the majority of respondents commented on the high bills they receive and considered the prices they pay are high compared to consumers not in embedded networks. Customers also told us they have difficulty validating the accuracy of the charges on their bills and they do not have access to off-peak rates or are charged a continuous rate".<sup>6</sup>

We note that the correlation between embedded networks and negative pricing outcomes has previously been acknowledged by the AER, recognising the structure nature of many of the issues in embedded networks, and the ability for many of these issues to at least be mitigated by removing the impediments to

<sup>&</sup>lt;sup>2</sup> AEMC, Updating the regulatory frameworks for embedded networks, Final report, 20 June 2019, p.iv

<sup>&</sup>lt;sup>3</sup> Committee on Law and Safety, Embedded Networks in NSW, Report, November 2022, p.17

<sup>&</sup>lt;sup>4</sup> Ibid, p.26

<sup>&</sup>lt;sup>5</sup> Ibid, p.vii

<sup>&</sup>lt;sup>6</sup> IPART, Embedded Networks, Final Report, April 2024, p.5

competition.<sup>7</sup> The growing impact of these issues is reflected in data published by the NSW Energy and Water Ombudsman, indicating it opened 231 complaints from embedded network customers in the October to December 2024 period (an increase of 91% compared to the same quarter the year before).<sup>8</sup>

# Data limitations in underlying information

The AER's draft decision has been guided by the Australian Competition and Consumer Commission's (ACCC) 2024 Inquiry into the NEM report and a research report from Bastion Insights. We note the data underpinning the ACCC's analysis was limited to the prices charged by eight authorised retailers. However, authorised retailers are estimated to make up only around 40% of all registered embedded networks, and accordingly, not accounting for the impact and influence of exempt sellers is likely to present an incomplete view of the pricing outcomes encountered by embedded network customers.

We also note that analytical limitations extend to the Bastion Insights study, where only 31 of the 182 surveyed embedded network participants were supplied by exempt sellers. Despite the small sample size, their report identified the lack of retailer choice and access to best market offers meant that only 1 in 5 participants were better off in an embedded network.<sup>9</sup> This suggests that the supposed pricing benefits from lower network costs and bulk energy discounts are either not being passed through to embedded network customers or have been overstated.

# Limited access by embedded network residents to Consumer Energy Resources (CER)

Regarding the purported advantages of embedded networks in facilitating energy efficient technologies and CER usage, we are aware there is often a lack of clarity and visibility about the extent to which residents are, or are not, receiving cost savings from CER infrastructure (e.g. if solar is powering individual premises in addition to common areas, then it is not clear how this cost saving is passed on).

We note also that customers encounter disadvantage in circumstances where CER and other technologies are not included the original development, design, installation and connections approvals process. The Bastion Insights report noted embedded network customers perceive access to CER and electric vehicle charging to be important, but commonly lack access to them. In practice they encounter significant barriers in initiating a CER installation including:

- wiring issues preventing the installation of rooftop solar or batteries at their individual premises;
- limited capacity on the network to host solar generation, resulting potentially in a low or zero fixed export limit being imposed; and
- difficulties in getting the ENO to enter into a connection agreement with the DNSP on behalf of the customer for their CER installation.

Rather than these factors, we understand that limited access to CER is commonly attributed to the fact that a large portion of embedded network customers live in apartments and multi-dwelling developments. However, when compared against retail market customers also living in apartments, embedded network customers continue to have significantly lower access, with Bastion Insights reporting that:<sup>10</sup>

12% of embedded network customers living in an apartment have access to at least one of the resources, compared to 34% of retail market customers living in an apartment. Retail market customers in apartments are significantly more likely to have access to:

- rooftop solar panels (23% vs. 5% of EN customers in an apartment)
- batteries to store electricity (19% vs. 2% of EN customers in an apartment)

<sup>&</sup>lt;sup>7</sup> AER, Submission to NSW Parliamentary inquiry into embedded networks, 8 July 2022, p. 3

<sup>&</sup>lt;sup>8</sup> https://www.ewon.com.au/page/publications-and-submissions/reports/EWON-Insights/ewon-insights-oct-dec-2024

<sup>&</sup>lt;sup>9</sup> Bastion Insights, Review of the Exemptions Framework for Embedded Networks, Research Report, May 2024, p.7, 17

### • EV charging (14% vs. 9% of EN customers in an apartment)

Even where a customer has a rooftop solar system connected to their premises, there is an opportunity for the ENO to profit at the customer's expense, as highlighted in the ACT embedded network review:<sup>11</sup>

Excess solar power generated behind a child meter will flow upstream and into an adjacent child connection point where there is a corresponding load. However, the adjacent child meter cannot distinguish if the power consumed is from the onsite solar system or from an external supply via the parent connection point. Therefore, the parent meter may record a lower consumption from the grid due to the onsite solar system, but there will be no change in the meter readings for the child meter which consumed the solar power that has flowed from an adjacent child connection point.

Under this scenario, there is nothing preventing the EN Service Provider charging the child connection point for the full charges associated with their meter reading (even if onsite solar was consumed), while at the same time, using the solar generated across the whole site to reduce their costs at the parent meter (i.e. charging a customer electricity that the retailer didn't pay for and profiting as a result).

### Enhanced transparency requirements would better protect customers from adverse outcomes

Importantly, the exemptions framework ought not permit exempt parties to be unfairly advantaged by less onerous regulatory requirements at the expense of consumers. Having regard to the findings of other reviews (including those referenced earlier in this Appendix A), we consider that it would be appropriate to increase the requirements within the guidelines to better shield customers from the risk of adverse outcomes. To better balance consumer protections and compliance considerations, we recommend that the AER require embedded networks to:

- provide greater transparency of any bulk pricing benefits and network cost savings they have accrued and explain how these are passed through to their customers;
- provide greater transparency on how the benefits of on-site CER are distributed between the operator and individual customers; and
- demonstrate as part of the application process the net benefit it expects to deliver to customers relative to a standard connection arrangement.

# To prevent the inefficient cancellation of planned network outages, stronger outage notification requirements are required

In our experience, the proliferation of embedded networks has contributed to an increase in the number of planned works that we have had to cancel on our shared distribution network, as a consequence of embedded network customers making us aware that they have not been given notice (by the embedded network) of the planned distribution network interruption.

Our notification obligations are prescribed under the National Energy Retail Rules (NERR) which, among other matters, require DNSPs to provide at least 4 business days' notice to affected customers. These provisions apply to customers with deemed standard connection contracts and do not extend to customers behind an embedded network's parent connection point. Instead, the Retail Exempt Selling Guideline places this responsibility on exempt sellers, and requires exempt sellers to pass on information about the planned interruption to each affected customer.

Operationally, there is a reluctance for planned interruptions to proceed when DNSP officers are informed on-site by an embedded network customer that they have life support needs and have not received a notification of the planned interruption. Although the life support obligations prescribed in the NERR pertain to on-market customers, there remains an obligation on ENOs to notify DNSPs of customers within the

<sup>&</sup>lt;sup>11</sup> Aurecon, Review of Embedded Networks in the ACT, Final Report, 12 May 2023, p.47

embedded network that rely on life support equipment.<sup>12</sup> In circumstances where these obligations are adhered to, a DNSP can factor this information into its planned interruption planning and notification process. As these issues pertain to embedded networks:

- DNSPs are unable to register or verify the life support status of customers and determine whether a notification has or has not been issued in accordance with guideline requirements; and
- the protection framework does not provide guidance on how information received from nondistribution customers should be managed by the DNSP, or clearly establishes that a DNSP should cease a planned interruption when a potential third-party breach is claimed by an embedded network customer.

While DNSP obligations do not extend to embedded network customers, we appreciate most embedded network customers are unlikely to understand the nuances of the regulatory regime. This consideration, combined with our organisation-wide commitment to protecting life support customers, compels us to cancel the planned interruption (or immediately restore supply) and defer the planned works until a later date. However, we are conscious that doing so:

- inhibits necessary planned works, and inconveniences both exempt and standard supply customers who will again be forced to make appropriate arrangements to accommodate the rescheduled outage;
- can delay both vegetation management activities critical to controlling bushfire risks and impacts
  of storm events, and the scheduled maintenance and replacement of assets at risk of failure
  exposing customers to poorer reliability outcomes; and
- can impact network augmentation and connection works and cause customers and developers to potentially wait several weeks before another suitable date for interruption can be mutually agreed.

In addition to these operational challenges, there is currently no recourse for us to recoup the costs of aborted works from exempt service providers where the cancelled planned interruption resulted from their failure to comply with their life support and/or outage notification obligations. Rather, it will be left to network customers to fund these costs and bear the financial consequences of breaches of exempt sellers, which we consider to be an inappropriate outcome in the circumstances.

We therefore consider this approach is not sustainable, particularly as strong growth in residential embedded networks continues. It is also likely that this scenario will become more frequent as the number of customers registering with life support needs continues to trend upwards. As such, we have considered potential measures capable of reducing the impacts from these disruptions by improving the interruption notification process. The most feasible options could be implemented through updates to the exemption framework and include:

- 1. requiring ENOs to provide DNSPs with confirmation a planned interruption notification has been issued to all affected customers;
- 2. establishing a mechanism allowing non-compliance of planned interruption notification obligations to be reported to the AER; and
- 3. enabling DNSPs to access the contact details of exempt networks and sellers.

We note that we have the system capabilities to demonstrate we have complied with our notification obligations at the parent connection point, but lack visibility over when and to which customer or premises

<sup>&</sup>lt;sup>12</sup> The exemption guidelines prescribe a process for sharing life support information which is contingent on the customer informing either the exempt seller or exempt network. Only exempt sellers are required to provide life support information to the DNSP, potentially creating an information gap for DNSPs where exempt network is notified of life support requirement. In addition, Condition 20 of the Retail Exempt Selling Guidelines and Condition 1.10 of the Network Exemption Guideline requires confirmation from a medical practitioner before a life support customer is registered. Confusion can arise because these conditions contrast with NERR arrangements where life support protections apply immediately after the authorised retailer or DNSP is notified by the customer.

within an embedded network these outage details has been passed on to. Access to this information would help us demonstrate to any customer that all parties have complied with their obligations to notify, or conversely, reveal instances where the notification has not been issued in accordance with AER guideline requirements.

Requiring exempt sellers to provide this confirmation as part of the notification requirements, in conjunction with a formal process enabling DNSPs and exempt customers to report breaches of the guideline notification requirements, would incentivise exempt service providers to improve their notification procedures and enable the AER to use this information to assess individual and industry-wide compliance performance. These requirements could also be supplemented with an obligation to provide DNSPs with up-to-date contact details to facilitate communication when addressing an embedded network consumer enquiry and investigating whether a DNSP's notice has been passed onto customers.

Another more significant potential measure, which we acknowledge would require further exploration and consideration in collaboration with the AER, customers and other stakeholders, is allowing DNSPs to recover costs incurred due to cancelled outages from embedded network operators. Guided by the general principle that risks should rest with those parties best placed to manage them, we consider that the incremental costs incurred from a cancelled interruption should be reallocated from network customers to the exempt party which has failed to provide the notification. The risk of incurring a financial cost would be a powerful incentive to ensure exempt parties have robust notification processes in place.

Cost recovery could be managed through an ancillary network service (ANS). Whilst ANS fees usually apply to customer requested services, they could be attributed to exempt parties under a user-pays approach similar to our current fees pertaining to planned outages for metering replacements where retailers are charged where we cannot complete a planned interruption due to factors outside of our control (e.g. we are unable to gain access or the other party fails to arrive for the purposes of replacing a meter).

The AER's decision to approve new ANS fees is contingent on DNSPs demonstrating customers and stakeholders have been consulted over the costs and the likely benefits they may derive from the service. There are also regulatory barriers to introducing new ANS fees within a regulatory control period, particularly when the new service does not fit within an existing service group. We consider it would be sub-optimal to delay the introduction of these charges until our 2029-34 regulatory period and we would be keen to understand the extent to which new charges to embedded network operators can be housed in the existing ANS listing and any specific engagement requirements to support their introduction.

A further potential measure would be to enable DNSPs to perform interruption notification activities within embedded networks. Under this option, DNSPs could leverage their existing capabilities to provide notifications to all child connection points, if possible, as a service upon request to ENOs.

Improved DNSP visibility of child connection points and access to customer premises and contact details will be required for this approach to be feasible. More broadly, we appreciate the AER may not be able to give effect to this option through changes to the exemption guidelines alone, and a more detailed consideration of the interaction with other elements of the regulatory framework and implications on customer outcomes may be needed. Nevertheless, we believe this option can deliver improved outcomes to both network and embedded network customers and therefore merits further consideration and we welcome opportunities to discuss ways it might be progressed alongside the other options outlined above.