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2 August 2010

General Manager
Markets Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email: AERInquiry@aer.gov.au

Dear Sir/Madam

Re: AER Approach to Retail Exemptions – Issues Paper

EnergyAdvice Pty Ltd (EnergyAdvice) welcomes the opportunity to provide comments in relation to the Australian Energy Regulator's (AER) issues paper on retail exemptions.

EnergyAdvice is a leading energy consulting company providing independent consulting and energy management advisory services, procurement strategies, bid negotiations and market analysis to a range of clients in all jurisdictions of the Australian energy market.

In principle, the approach taken by the AER to provide clarity and certainty surrounding energy onselling arrangements via the centralisation of regulation for both electricity and gas retailing and, we trust, electricity distribution networks, is strongly supported by EnergyAdvice.

We have responded only to those issues that are relevant to EnergyAdvice's clients, and for ease of reference, we have adopted the same numbered questions as in the Issues Paper.

Yours sincerely

Ian Delahunty
Contracts & Regulatory Manager

EnergyAdvice

The future is now

Response to:

AER Approach to Retail Exemptions - Issues Paper

Submitted by:

EnergyAdvice Pty Ltd

2 August 2010

www.energyadvice.com.au
Melbourne Sydney Brisbane

Submission to the AER Approach to Retail Exemptions - Issues Paper

Q4: Is the apparent growth in onselling problematic, and if so, why?

The growth of on-selling arrangements per se is not a problem, it's more the current uncertainty in relation to different state based regulations. In that respect the nationally consistent approach proposed by the AER is welcomed.

The increase in shopping centres for example has added to the growth in onselling as in these situations there are many benefits to customers of exempt sellers, (alignment of business operations, minimising third party contact in relation to disputes which may arise as part of the business etc). Additionally, tenants may have better capacity to resolve billing and service issues rather than through a large energy retailer as well as access to better pricing via the onseller.

Q5: Is it appropriate for the AER to impose no conditions on large customers of exempt sellers (as is the case for large customers of authorised retailers), or should they be provided with basic customer protections where the existing arrangements prevent them from choosing their own retailer?

Appropriate consumer protections should be afforded to any customer whether or not they have a choice of retailers.

However, it needs to be recognised that in some circumstances, consumer protection in other forms may be more appropriate. Tenants in shopping centres for example will already be provided such protection under existing tenancy laws. In these situations, compulsory compliance with a particular dispute standard under electricity laws may potentially hinder and frustrate resolution of matters better managed under normal landlord/tenant arrangements.

We would however question AER's definitions of small and large customers. The definition of small customers used in the AER Issues Paper is 100 MWh and 1 TJ, whereas the market definitions (in most State jurisdictions) are 160 MWh and, (arbitrarily) 10 TJ. It is in Queensland only that the defined size of a small customer (100 MWh) matches the AER definition.

We consider the AER, in determining protection levels for onselling customers, should take into account the costs associated with complying with consumer protection mechanisms. A retailer operating in the open market can spread their compliance costs over a great many users who may be classed as small customers. In the case of an exempt seller in a shopping centre for example, their compliance cost will be spread over a smaller customer base and higher site cost recovery.

Q6: Should the AER impose a condition on onsellers selling to large customers to ensure that they do not hinder or prevent the customer from choosing their own retailer?

Do not agree. If a large customer can access choice of retailers then market conditions should dictate whether or not they choose an onseller. An imposed condition is therefore not required. The issue for the AER to consider is should any conditions be required where infrastructure does not permit a customer to choose their own retailer, as is currently the position in Queensland.

Q7: How important is it for customers in onselling situations to have access to choice of retailer?

Choice of retailer, where circumstances permit, should be the right of all consumers.

We do not however agree with the AER's view that exemptions should not be granted to onsellers where all customers have access to a retailer of choice.

Despite customers' access to a retailer of choice, an onseller with the ability to offer pricing in competition to a retailer may be able to provide, in addition to a competitive price, superior service, commercial conditions and better understand the customers' specific needs. We therefore do not believe retailer of choice access, nor customer numbers ought to be a determining factor in the granting of an exemption.

Q8: Once network configuration/metering issues are addressed, are there any other impediments to exempt customers having access to choice of retailer for electricity?

We consider that AER should give consideration to who is responsible for costs associated with network configuration and network metering, particularly in a legacy infrastructure, where the overall capital expenditure may outweigh any price benefits accruing to a customer with a 2-3 year payback window.

AER should also review the processes and billing arrangements that retailers will undertake when a customer of choice is supplied via a gate meter. We recommend reviewing SA & Queensland business processes which are likely to undergo the most significant change in procedure.

Q10: What core customer protections should exempt sellers be required to provide for their small customers?

We do not necessarily consider that small customers within an embedded network arrangement need to be granted the same protections and contractual rights as an open market small customer, if that is what the AER is considering.

If excessive compliance costs associated with complying with onerous consumer protection mechanisms are required for onsellers, then potential onsellers are likely to think twice about participating in a market. This would ultimately be to the detriment of small customers who may miss out on the benefits that embedded networks generally have.

Q13: Are there any conditions which the AER could impose which might help to mitigate the risk of an exempt seller failing and leaving its customers without supply? Would it be appropriate for the AER to do this?

There is generally a large capital investment associated with the installation of an electricity distribution network which may have been funded by entity operating as the exempt seller. AER has stated that it is not *"unacceptable for an exempt seller to earn some level of profit which reflects the efficiencies attributable to exempt sellers versus the cost of administering the onselling arrangements".* We consider that the implementation of a fair, practical and reasonable set of regulations associated with onselling arrangements, for onsellers and customers, to be the most effective way to mitigate the risk of an exempt seller failing. Other factors that may cause an onseller failing are outside the control of the AER.

Q18: What sort of tests should the AER use to determine whether the sale of energy is incidental to a business?

Q19: Is the approach taken to the 'incidental' requirement in the categories of deemed and registrable exemptions appropriate?

We do not fully agree with the AER's view that *"Where the sale of energy cannot be avoided it would be considered incidental, but where it can be avoided, it would be considered a core business activity.*"

Generally entities, particularly shopping centres, retail energy because they own the embedded

network. Whether they would or would not onsell if they didn't have a network would be driven by their particular circumstances. In these situations, (except in Queensland), the sale of energy could be 'avoided'. However the fact that onselling could be avoided does not mean that selling energy is the core part of the business even if it is a choice made by that entity. Whilst onselling provides a benefit to both customer and onseller, the onseller's core business would continue, irrespective of the sale of energy.

In our experience, in most, or even all cases of onselling, the sale of energy is 'incidental' to the business, in that the core business would continue even if there was no onselling. We suggest that a very large proportion of these arrangements should be granted a deemed or registerable exemption, or in some few cases, (for example a large industrial entity supplying a single site), an individual exemption.

Q21: How should the AER judge an exempt seller's profit intentions?

AER has stated in the Issues Paper that the obligations of an individual exemption are *"likely to more closely resemble the obligations that apply to an authorised retailer"*, whilst deemed and registerable exemptions may have fewer conditions attached to them.

The AER's view that an exempt seller should not be able to pass on a fee for meter reading or similar fees is not consistent with this approach. In imposing obligations of a retailer on exempt sellers, the AER ought to afford the exempt seller some of the rights.

Market retailers charge fees to customers for a number of services such as meter reads, meter connections, testing of meters, de-energisation, faults etc. Subject to the exempt seller properly disclosing such fees to customers, onsellers should not be prevented from charging similar fees.

EnergyAdvice believes that any customer is better served by transparency in their energy charges. A customer will always gain the best pricing and conditions if a retailer's services and charges, as much as possible or appropriate, is 'unbundled'. That way the competitiveness of an offer may better be assessed. Bundling of an exempt seller's fees and charges, as the AER has suggested runs contrary to this notion.

In relation to judging an exempt sellers profit intention we consider, subject to compliance with appropriate consumer protection mechanisms, an onseller ought to be able to profit from an onselling arrangement and note the AER is not against this philosophy. Provided that consumers are informed as to the basis of all charges applied by an onseller, and have access to either a regulated or a competitive environment through which an appropriate market price for electricity can be determined then, subject to the onseller complying with an appropriate cap, their profit intentions should not be of interest to the AER.

Q22: Will the proposed pricing protections adequately protect exempt supply customers?

In our experience, onsellers wish to cover their energy supply costs, the costs of their network and any ongoing maintenance and administration charges. We are not aware of any onseller whose primary purpose in onselling is to make large profits from the activity.

Where customers do not have a choice of retailer, then the current mechanism of capping charges at the relevant standing offer is, we believe appropriate and provides clarity and certainty to all parties.

In circumstances where choice of retailer is available, a cap is not appropriate as customers will have the ability to switch between electricity sellers to take advantage of the best price available.

Q38: Do stakeholders agree with the AER's registration threshold of 25 premises with a single site? Why or why not?

Customer numbers is not a relevant criteria in contestable markets. We consider rather than basing a category, or class on customer numbers, greater emphasis should be placed on consumption thresholds and the relationship between embedded network ownership and retailing activities.

Given the "bundled" structure of many embedded networks, we see a number of issues arising when the AER seeks to deal with retailing issues independently of network rules and arrangements.

Q39: Do stakeholders agree with the AER's proposed Class 1 deemed exemption? Why or why not?

Q44: Do stakeholders agree with the AER's proposed Classes 4 and 5 deemed exemptions? Why or why not?

Agree in principle. However we question why Class 1 is required at all. We believe that "customer numbers" as a category serves no useful purpose except to exempt an onseller to less than 25 small customers from registration. Subject to appropriate transition periods and appropriate compliance requirements, ultimately it may be in the interest of onsellers and customers alike to have some form of registration in place.

Additionally, circumstances where there is a mixture of small and large customers are not

accommodated under any other class. Similarly, if a small customers' consumption alters such that it moves from being a small customer to a large customer (or vice-versa) the mechanism to cover this is not addressed.

We also consider there should be a class or category created for the "bundled" retailer/network owner. Many onselling entities operate as a bundled service provider, providing a retail service with Local Network Service Provider (LNSP) and metering obligations. We urge the AER to consider network exemptions concurrently with the retail exemptions process.

We are aware that there are some sites that have "gifted" the embedded network back to the LNSP as part of the construction and connection arrangement. These are generally on an open access arrangement, and are neither a retailer or network operator/owner and do not currently fit into any of the classes or categories proposed.

Consideration may also need to be given to the circumstances where an onseller is providing both electricity and gas on the same site. Will separate exemptions be required?

Q47: Is the approach of allowing a transitional deemed exemption that will be replaced by a registrable exemption appropriate? Will the proposed expiry date allow sufficient time for the relevant exempt sellers to register?

We do not believe there will be general opposition to registration from current or potential onsellers.

We do have concerns however relating to migration of current State based statutory legislation, and whether that may be effectively carried out in time. Whilst there may be limited changes to NSW and Victorian legislation required, more substantial changes to SA & Queensland legislation, operations, business rules and administration will need to be implemented.

Given the notional transfer date of 1 July 2011, a suggested registration date of 30 June 2013 provides a transition period of two years. As most electricity agreements are entered into on a 3 year basis, we suggest a longer period should be considered to allow these agreements to expire.

Transitional arrangements should be established to provide a balance between customer benefits and the commercial and sunk capital position of the bundled service provider that entered into the arrangements to supply energy to customers and/or comply with current regulatory arrangements.

Additionally any legislative changes could affect onsellers who may have energy contracts containing take or pay (TOP) obligations. An onseller in Queensland for example may be left with large ToP obligations if there a major churn to 2nd tier Retailers within the current contract period.

Q48: Should individual exemptions be time-limited?

Most investment decisions by large organisations are made on a long term basis with significant amounts of money involved. Limiting the time of individual exemptions may impact that decision making process. If a limitation is applied, we consider exemptions need to be in place for a minimum of 5 years and, subject to no material change at the site, there ought to be an automatic granting of an exemption for a further period.