5 February 2024

Independent Pricing and Regulatory Tribunal (**IPART**)
Level 16, 2-24 Rawson Place
SYDNEY NSW 2000

To whom it may concern

IPART - Embedded Networks Draft Report

Energy Locals Pty Ltd (ACN 606 408 879) and its related entity, Energy Trade Pty Ltd (ACN 165 688 568) (**Energy Locals**) welcomes the opportunity to provide a submission to IPART in relation to its draft report on pricing in embedded networks, released in December 2023 (**Draft Report**).

We understand that as part of the NSW Government's Embedded Network Action Plan, IPART has been asked to make recommendations on:

- how maximum prices should be set for electricity, gas and hot and chilled water supplied through embedded networks;
- a compliance and enforcement framework for new price protections; and
- whether new hot and chilled water embedded networks should be prohibited.

Energy Locals strongly supports the enhancement of protections for embedded network customers but has significant concerns that the framework currently recommended in the Draft Report will reduce the benefits of embedded networks for customers, as well as acting contrary to the government's push for more affordable housing by raising the cost of new build apartments. As a result, we fear that if implemented, the recommendations will have the effect of preventing consumers from benefiting from smart, more efficient essential services in new homes and lead to a lack of price and service predictability, reliability, and transparency for embedded network customers.

Through this submission, Energy Locals aims to emphasise the importance of targeted and relevant measures to ensure that the benefits of embedded networks can be recognised by customers and the community to the fullest extent without impacting opportunity for growth and innovation.

This submission will detail:

- Energy Locals' business and contracting structure;
- feedback on IPART's proposed Pricing Objectives;
- proposed alternatives for recovery of infrastructure costs;
- details of active competition in embedded networks;
- counterarguments to IPART's claims that embedded network sellers have a lower cost to serve;
- concerns with the proposed maximum price methodology for hot water; and
- suggestions for supporting consumer protections.

1. About Energy Locals

Energy Locals specialises in energy procurement and management, energy generation and the provision of energy efficient technologies for residential, commercial, and industrial projects. We have extensive expertise in the management and implementation of embedded networks, which include electricity, gas, hot water, solar PV, electric vehicle charging, battery storage and telecommunications.

The Energy Locals Group are subsidiaries of a Quinbrook Infrastructure Partners (**Quinbrook**) managed fund. Quinbrook is an ESG-focused, 'value-add' global investment manager with a specialist focus on low carbon, renewable energy supply and related assets and business and has invested more than US$2.5 billion in over 200 low carbon, renewable, storage and grid-supply projects across the UK, USA, and Australia.

We provide an end-to-end solution for our embedded network clients, which typically involves the following:

[redacted]

[redacted]

We take pride in our ability to provide support throughout the lifecycle of the building. Whether it be collaborating in the early design stages and offer guidance on infrastructure needs and recommending efficient solutions or working with building owners to deliver tailor benefits such as clean energy installation and reasonable pricing solutions, we are ultimately working towards providing a high-quality service to our end-user customers.

[redacted] In the case of greenfield sites, where an owners' corporation and residents do not exist at the time that the developer makes key decisions around onsite infrastructure, we ensure that such infrastructure is designed and sized to meet the long-term needs of residents.

2. IPART's proposed pricing objectives

Energy Locals applauds IPART's ambitious proposed pricing objectives and is very supportive of the implementation of a regime that achieves such objectives. We understand that IPART has acknowledged that, due to the competing interests of customers, sellers and the regulator, some objectives will work in opposition to each other, and we agree that this may be acceptable to an extent. However, after reading the Draft Report, we are concerned that these objectives will not only work in opposition to each other but will likely have a detrimental impact on one or more stakeholders, while trying to achieve a positive outcome for another.

For example, re-pricing embedded network customer tariffs every six months may allow for cost reflective pricing based on the short-term spot market movements, but it is also likely to create disproportionate regulatory costs, cause stress on retailers' ability to meet service standards and cause price instability and stress for customers.

In particular:

- reprice events are typically stressful times for customers, and in our experience, this is the case even during price reductions, when media coverage may have set expectations of large price falls based on short term spot price movements;
- reprice communications and the adjusted tariffs that follow on bills lead to significant increases in customer calls, emails, direct complaints, and ombudsman cases. [redacted]
- it is likely to require embedded network operators to adopt shorter-term hedging strategies, which are unlikely to mirror the underlying hedging strategies used by on-market retailers for

[redacted]

their offers that will form the basis of the proposed benchmark[1]. This could lead to financial instability of retailers as we witnessed during the volatile market in 2022 when market retail pricing did not keep pace with current spot prices.

As a result of the above impacts, Energy Locals has long held a strategy of changing customer prices once each year in order to support a more stable hedging strategy and to provide customers with price certainty over a medium-term period. In our experience, this has been welcomed by customers who often join the retail side of our business after experiencing a reprice event soon after joining another on-market retailer. [redacted]

Another example is the impact of benchmarking embedded network prices to the median of the lowest market offers. While this may be beneficial for embedded network customers in the short-term it will not be sustainable for a number of reasons:

- each retailer's lowest offer in market is likely to be their acquisition offer, which is priced competitively to attract new customers but, in many cases, will not truly mirror the actual underling cost of goods base that the retailer bears and can therefore tend to be short-lived;
- the DMO benchmark is intended to allow retailers to recover their efficient costs and to provide incentives for consumers to engage. If a retailer is required to consistently meet the proposed lower benchmark, this purpose would not be achieved – see section 6;
- retailers may price more aggressively in certain distribution zones and be less competitive in others and so this approach does not allow for flexible pricing across distribution zones; and
- it will likely have the effect of discouraging sustainable energy solutions and accommodating innovation and investment in the energy sector. This is because, benching embedded network prices to on-market offers assumes that embedded network and on-market retailers need to recover the same efficient costs of supply. However, as Energy Locals operates as a licensed retailer, its cost to supply to embedded customers includes many of those costs to supply to on-market customers. For example, the cost to comply with the National Energy Customer Framework (**NECF**), including service standards, compliance monitoring and performance reporting. In addition, embedded network sellers have additional costs that would normally be borne by customers or the network operator in on-market scenarios.

3. Recovery of infrastructure costs

IPART's Draft Report acknowledges that energy prices are not the only mechanism for recovering costs, embedded network providers can also charge the OCs for their services, such that a regulated maximum price for hot water/energy would not cap a provider's ability to recover its costs. IPART also observes that it is appropriate for OCs to incur internal infrastructure costs, as they, rather than individual tenants, are better able to manage these costs.

[1] [redacted]

The recovery of the infrastructure charges via agreements with an OC will not be without difficulties as:

- [redacted]
- [redacted]
- [redacted]

We foresee a number of flow-on consequences arising from the inability of embedded network operators from being able to recoup investments, which are set out below.

a) *Impacts on access to sustainable energy solutions*

If embedded network operators are unable to recoup investment and therefore less likely to invest in these buildings, residents will have less access to sustainable energy solutions and there will be less access to innovation and investment in solar PV, batteries, and electric vehicle chargers to NSW apartment residents.

b) *Misalignment of interests*

Where a different party, such as an OC, provides network infrastructure as distinct from the supply of energy, there is a risk that a non-alignment of interests may result in cheaper inefficient infrastructure being installed that increases the future cost of energy supplied to customers. If an OC is responsible for the operation of an inefficient system and is naturally also bound by the IPART price cap, it will be uneconomical for the OC as the operating costs will outweigh the allowed cost recovery from customers. In this circumstance, the OC will have three choices:

- accept the negative cost recovery and use the sinking fund or raise new funds from owners to pay for it on an ongoing basis, which will lead to rent increases;
- ask an embedded network operator to fund a more efficient system, noting that the inefficient one may have only recently been installed. This will lead to a service disruption for customers and require the OC to commit to fund it during the contractual term limit, which will also have the effect of increasing rent; or
- in the case of hot water, the OC may decommission the centralised system and require owners to install individual hot water systems. We have investigated this in the past and found that individual systems take up space that often doesn't exist and are uneconomic compared to centralised systems.

c) *Housing development*

The escalating cost of housing development has become a predominant factor contributing to the surge in property purchase prices and rental rates. As urban areas undergo rapid development, construction expenses, land acquisition costs, and regulatory requirements have all witnessed significant increases. These mounting financial pressures are invariably passed

on to homebuyers and tenants, translating into higher property purchase prices and escalating rental rates.

Contributions to developments by embedded networks can help relieve the pressure of infrastructure costs on property developers. As acknowledged by the AER in it's review of the AER Exemptions Framework for embedded networks "developers may achieve cost savings if they can avoid the need to establish wires and other relevant infrastructure for the direct connection of each individual residence to the grid'.[2] It is clear that constructing higher-density apartment complexes as embedded networks on greenfield sites has the potential to decrease construction expenses and expedite the building process.

However, if the costs of these networks are initially borne by the OC, it is likely that such costs will be passed through to the end-user via rent increases and have the same effect but in a far less regulated industry. This will have the balloon-squeezing effect of reducing a line item on a customer's bill but provide landlords with a justification to increase rent by at least the same level. We do not believe that this approach is in the interest of cost-reflective pricing.

We see a significant risk that the current IPART recommendation will lead to an improvement in one area and a series of cascading, negative consequences in other areas. These consequences are likely to have a more significant detrimental impact than any expected savings presented by the IPART recommendations. Assets aren't free, and someone needs to pay to keep them running. The current model provides for this, whereby retailers pass use of system charges (**TUoS and DUoS**) onto customers regardless of their usage. This covers the fixed investment cost in the network assets. This is understood and accepted and is consistent with the principle of cost reflective pricing. We believe the same infrastructure recovery model is entirely appropriate whether that network be a street in Wagga Wagga or an apartment building in Newcastle. In both cases, the infrastructure that use of system charges recover sits outside the boundaries of the home or apartment that a customer owns or rents. We do not believe that blending charges for embedded network electrical infrastructure into strata fees is consistent with the principle of cost reflective pricing which governs electricity network charges more generally. [3]

4. Competition in embedded networks

IPART's Draft Report states that customers in embedded networks cannot benefit from retail competition by shopping around for lower prices. Energy Locals acknowledges that, due to current market processes and restrictions, it is not simple for individual customers in embedded networks to switch retailers if they are unhappy with their supplier. However, to claim that there is an absence of competition in embedded networks is not correct.

During the lifespan of an embedded network, there are multiple opportunities for counterparties to negotiate the best outcomes for residents in embedded networks. We have set out some examples of this below.

[2] Australian Energy Regulator, "*Review of the AER exemptions framework for embedded networks – November 2023'*, p. 20
[3] AEMC, "*National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014*", 2014. See: https://www.aemc.gov.au/sites/default/files/content/da5cc66f-e950-48e0-9277-53db79dd25e8/Final-determination.PDF

a) *Negotiation of the Establishment Agreement*

[redacted]

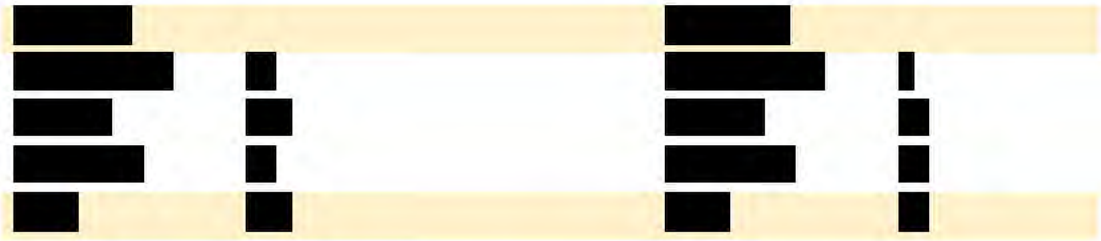
b) *Negotiation of the Services Agreement*

It is not guaranteed that just because we have been engaged to procure and install the [redacted]

c) *Takeovers and retention*

With the introduction of limits on the term of agreements with OCs for the supply of utilities, the embedded network industry has experienced a significant increase in site churn and therefore the need for strong retention strategies and competitive offers in the market.

[redacted]



Takeover opportunities typically arise when OCs identify a need for change in embedded network service provider, typically driven by price or service-related issues. In these circumstances, OCs, and the residents that they represent, have access to significant competition in the market and, in some cases, this process has been so competitive that Energy Locals has had to forgo the opportunity.

d) *Churn of individual meters*

Customers in an electricity network have the ability to churn the energy supply to a different retailer. The current framework and ability for customers to do this is made difficult by the current rules relating to installation of meters and retailers are not required to accept the network charges from the incumbent embedded network operator. Energy Locals would welcome a review of these rules to allow residents easier access to competition.

Therefore, while it is not simple under the current rule framework for individual customers in embedded networks to switch retailers if they are unhappy with their supplier, it is incorrect to claim that there is no competition in embedded network markets. Residents in these embedded networks are represented by property developers, energy brokers, OCs and build-to-rent operators who are incentivised to negotiate the best outcomes for their residents and are better placed to advocate on behalf of their residents as they have significantly more bargaining power as a collective.

As such, it is clear that a price cap that is set to achieve competitive outcomes, such as the Default Market Offer (**DMO**), is appropriate for embedded networks to maintain incentives for competition, innovation and investment by retailers and embedded network operators. Setting a price cap any lower than the DMO will likely have the effect of stifling innovation and discouraging investment in greener and more efficient energy solutions, while simultaneously leaving OCs to manage the problem of balancing the economics of paying for expensive assets with a price cap that is set at a level that will encourage the use of inefficient equipment.

5. Lower efficient costs of supply

IPART's Draft Report states that the efficient costs of supplying embedded network customers are significantly lower than the efficient costs of supplying an equivalent on-market customer, which is mainly due to lower network costs, the absence of customer acquisition and retention costs and the ability to install generation assets at some sites. Energy Locals submits that this statement demonstrates a substantial misconception of how embedded networks operate and the costs involved. We have elaborated on this below:

a) *Electricity network costs*

Network tariffs are charges by distribution network service providers (**DNSP**) to recover the costs of investments made to develop and build the infrastructure required to deliver energy. In the case of embedded networks, the DNSP is responsible for delivering energy to a single connection point (termed a parent connection) for the site. An embedded network owner/operator is then responsible for procuring, installing, operating, and maintaining the infrastructure behind the parent connection which is used to deliver energy across the embedded network to each individual consumer connection.

Energy Locals does not dispute that embedded network tariffs set by DNSPs are normally lower than the sum of residential network tariffs at each premise for the equivalent electricity. However, we submit that this reflects embedded networks being lower cost to serve from the perspective of the distributor relative to the distributor serving the constituent end-users individually. This is consistent with Endeavour Energy's recent statement that "[s]ome of these savings reflect the lower costs imposed on the network by an embedded network".[4] Distributor costs are lower for embedded networks because the embedded network owner/operators contribute significant capital resources to building, operating, and maintaining these parts of the network.

[redacted]

The proposed pricing methodology, based on the incorrect assumption that an embedded network owner/operator's cost to serve is lower due to lower 'network costs', will have the effect of preventing embedded network owner/operators from recovering the costs of investments made to develop and build the infrastructure behind the parent connection point. Considering that equipment such as battery storage installed in embedded networks ultimately takes pressure off the national distribution network (and therefore its relevant costs), it seems inherently unfair to disregard the contributions made by embedded network owner/operators and prevent recovery of such costs.

b) *Acquisition and retention costs*

IPART previously introduced the concept of customer acquisition and retention costs (**CARC**), which incorporates retailer 'spend' to win new customers and retain current ones as a consideration when determining retail prices. CARC includes the costs of marketing and advertising campaigns, reward, and loyalty programs. While embedded network owners/operators may not market their products in the same way as on-market retailers, there is still a significant cost involved in both acquisition and retention in this market.

Embedded network operators spend substantial time working with potential developer clients to design solutions that fit their requirements. This involves the time of a business development person but also highly skilled engineers, project managers and modellers.

As stated above, embedded network owner/operators may offer substantial discounts to energy plans, financial credits for residents and common area accounts and other incentives such as green power at no additional charge or electric vehicle chargers for the building. All of which are significantly beneficial to residents of these buildings.

The above examples contradict IPART's assertion that the allowance for CARC is not applicable to pricing for embedded network customers. In fact, removing the allowance for

[redacted]

CARC and benchmarking prices to the median of the lowest market offers (likely to be temporary acquisition offers) may eliminate competition in the embedded network industry and prevent embedded network owner/operators from offering incentives, rewards, or loyalty programs due to smaller margins based on lower customer tariffs. This means that, although end-customers may enjoy lower customer tariffs, more targeted customer incentives and benefits will become unavailable to them. Energy Locals submits that, by removing this ability for competition in the industry, customers will be disadvantaged and have less access to greener and more efficient energy solutions.

c) *Energy generation assets*

Energy Locals is committed to reducing energy costs through sustainable technologies such as energy generation and storage assets. As of the date of this submission, we have installed [redacted] at no upfront cost to the building owner or its residents. Energy Locals has contracted a further [redacted] However, the suitability of a site for the installation of distributed energy resources (**DER**) such as solar PV and battery storage is dependent on a number of factors, including space, commercial feasibility, and building design. Unfortunately, it is not appropriate in all circumstances.

Installing solar on embedded network properties often incurs additional costs due to equipment required to ballast and tilt the panels on flat concrete roofs along with crane hire and traffic control fees related to work on tall buildings.

The limited roof areas of embedded networks often restrict the capacity of solar to matching energy use in common areas with limited opportunity for direct savings on the electricity bills for individual occupants. Energy Locals' embedded network sites with installed PV currently provide solar generation to individual apartments on a first-come-first-serve basis rather than supporting a managed equitable allocation. While Energy Locals would be supportive of projects that enable fair individual allocations of solar generation, developing new sites and especially retrofitting existing sites would be challenging both from a technological and financial aspect given the expected high costs to implement. It would require unanimous approval from all apartment owners which is expected to be difficult to achieve given the complexity and costs involved.

Regardless, the generation of electricity from on-site solar can have a limited impact on electricity prices in some buildings as it is only available during the day when residents often use less electricity. While including battery storage on site would help alleviate this issue, the cost of battery storage remains prohibitive rendering it commercially unfeasible to install in most circumstances.

Therefore, it is not correct to state that embedded network owner/operators can reduce costs of supplying electricity by installing generation assets at the site and, as such, contribute to a lower cost to serve embedded network customers as the installation of DER is not appropriate on all sites and it does not consider the upfront costs of such assets, which need to be recovered in some way.

6. Maximum price methodology for electricity and gas

As mentioned above, IPART's proposed that the maximum price for electricity and gas would comprise:

- a consumption charge equal to the median consumption charge of the lowest consumption charges from the offers of active retailers in the market' and
- a daily supply charge equal to the median supply charge of the lowest supply charges from the offers of active retailers in the market.

While we can understand the rationale behind IPART's proposed methodology, we anticipate that a number of unanticipated consequences could arise as a result. We have set these out below.

a) Acquisition offers are temporary

The lowest offer made by each retailer in the market is often their acquisition proposition, designed to be competitive and attract new customers. However, in many instances, this offer may not accurately reflect the true underlying cost of the goods borne by the retailer, making it likely to be temporary. Australian Competition and Consumer Commission (**ACCC**) analysis supports this suggesting that retailers recoup their costs over a customer's lifetime, by setting attractively low acquisition offers and making subsequent unilateral price increases over time.[5] For example, in 2023, 82% of residential customers were on calculated annual prices at or above the median offer on Energy Made Easy, which was a significant increase from 43% in 2022.[6] This suggests that retailers apply different pricing strategies to their existing customers compared to their acquisition offers.

For on-market retailers, the expectation of a positive return across the cohort rests on the expectation that a significant share of each cohort remains with the retailer beyond any initial discounting period (i.e. rolling off the acquisition offer over time). We submit that on-market retailers would not be financially viable if prices were regulated to match current acquisition offer rates for 100% of customers, 100% of the time. Yet this is what IPART is proposing for embedded network operators. In its submission on the introduction of the DMO, the ACCC stated:

> *"The ACCC considers that the AER has struck an appropriate balance in its methodology for setting DMO prices at levels that are low enough to minimise the 'loyalty tax' currently levied on disengaged customers, while not being so low that they would risk stifling competition or would not enable retailers to recover their efficient costs in servicing customers. We consider it critical that the DMO is not set at too low a level because of the benefits that competition drives, including efficiency and innovation."*[7]

Over many years, IPART has echoed the sentiments of the ACCC with regard to concern about setting regulated prices below efficient costs and ensuring headroom for retail market competition. In IPART's 2013 Retail Price Determination, in the context of explaining its customer acquisition and retention cost allowance, IPART stated:

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[5] Australian Competition and Consumer Commission, *'Inquiry into the National Electricity Market – December 2023 Report'*, P. 9.
[6] Ibid, P. 68.
[7] ACCC, "*AER Default market Offer, Submissions to the Draft Determination*", 20 March 2019, p2. See: https://www.accc.gov.au/system/files/ACCC%20Submission%20to%20AER%20on%20Default%20Market%20Offer%20Draft%20Determination%20-%2020%20March%202019.pdf

"Some current market offers are below our estimates of the short-term efficient cost of supply."[8]

Further, one could argue that on-market customers have the ability to switch retailers once the 'acquisition offer pricing' expires, however the ACCC's analysis indicates that this is not what is happening in reality. For example, the ACCC found that 70% of customers in 2023 are on plans that they entered into prior to 2022 and approximately 64% of customers on these older plans are paying a calculated annual cost equal to or above the DMO, as opposed to 31% of customers on newer plans.[9]

Temporary acquisition offers and lack of participation by consumers in the market is likely the reason for the high number of customers on plans equal to or higher than the DMO. For example, the ACCC sampled flat rate plans for over 5 million existing residential customers on market retail contracts and found that, in August 2023:

- 47% of residential customers were on plans with a calculated annual cost equal to or higher than the DMO; and
- 42% of concession customers were on plans with a calculated annual cost equal to or higher than the DMO.

The above figures also assume the customers received all conditional discounts that they were eligible.[10] It also contradicts IPART's statement that the DMO is "at the higher end of what on-market customers are paying".[11]

Additionally, from review of the historical data provided by IPART, we note that there is quite a spread of prices in the market offered by individual retailers. Many retailers would appear to employ a deliberate policy of price discrimination and aim to lower marketing costs by targeting new customers with heavily discounted acquisition offers, while maintaining the majority of their customers on much higher price plans. No retailer could survive if it operated purely at the lowest median level in the market in perpetuity unless market offers rose in unison.

Therefore, it is apparent from the above, that it is unlikely that on-market customers are actually paying an amount equal to the median of the lowest prices of all retailers displayed on Energy Made Easy for the terms of their contracts. Based on current and historic movement of customers, on-market retailers can rely on 'sticky customers' when determining prices and can get comfortable taking the risk that they will be able to recoup costs arising from low acquisition offers over the customer's tenure with that retailer.

If IPART's proposed methodology was introduced, embedded network sellers would not have the ability to recoup costs arising from low acquisition offers as their prices would always be capped at the median of the lowest offers available on Energy Made Easy every six months.

b) Future relevance of methodology

In producing the maximum price methodology, IPART utilised historic figures from the last four years to demonstrate that the median of the lowest tariffs for electricity has been around 15% lower on average than the DMO.[12] This is demonstrated in figure 4.1 below.[13]

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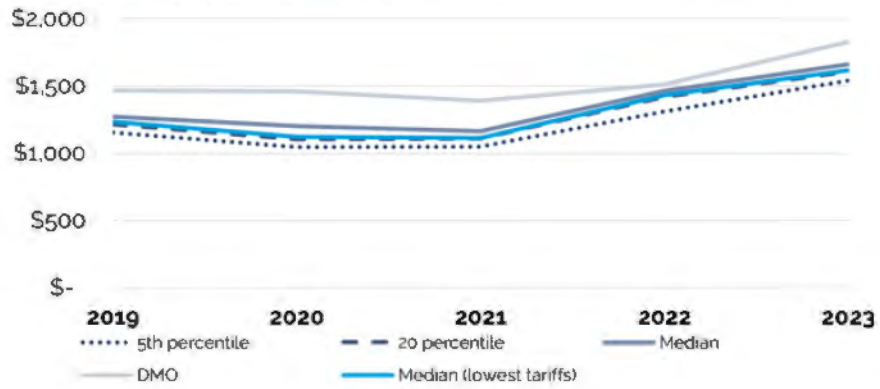
[8] Independent Pricing and Regulatory Tribunal of New South Wales (**IPART**), "*Review of Regulated Retail Prices for Electricity from 1 July 2013 to 30 June 2016*, June 2013, p 110.
[9] Ibid, P. 69-70.
[10] Ibid, P. 5.
[11] Independent Pricing and Regulatory Tribunal, NSW, '*Embedded Networks, Draft Report, December 2023*', P. 43.
[12] Independent Pricing and Regulatory Tribunal, NSW, '*Embedded Networks, Draft Report, December 2023*', P. 97.
[13] [redacted]

Figure 4.1 Comparing market offers to the Default Market Offer for a typical customer since 2019 (Ausgrid network)



The above graph from the draft IPART decision paper appears to include data on an annual basis and therefore does not look at specific market fluctuations that occurred during this period. In its November 2022 report, the ACCC displayed market offers of a representative retailer as a percentage of the standing offer in force in each region at that time by filtering to the cheapest offer from each retailer and then identifying the median offer for those minimum offers. Both the ACCC and IPART figures assumed a usage profile consistent with the standing offer in each distribution zone. The results of this analysis. which are set out in below, look jarringly different to the IPART graph included above and demonstrate the volatility of the market when looking at the data on a short-term basis.[14]

Median of minimum and median of maximum market offers compared with the Default Market Offer and Victorian Default Offer, residential single rate, June 2020 to October 2022

As we know, past pricing is not an accurate indicator of future market tariffs and, it seems, neither is taking the median of four years, considering that the lowest median tariffs were 5% lower than the DMO.[15]

The ACCC collected cost stack data from retailers throughout 2023 and this data demonstrates the impacts of high and volatile wholesale prices on retailers' costs in 2022-23. As disclosed by the ACCC, "retail margins in the NEM have now declined from making up 8.9% of an average retailer's residential cost stack in 2016–17 to 2.3% in 2022–23."[16]

Therefore, Energy Locals implores IPART consider whether the proposed maximum price methodology will be able to withstand market volatility and produce appropriate maximum prices in the future that will not eradicate retailer margins to unsustainable levels, ultimately

[15] Ibid.

[16] [redacted] *rket – December 2023 Report'*, P. 4

leading to further lessening of competition in the market with the exit of small retailers and uncertain pricing conditions.

c) *Our analysis of the historical data*

We are grateful to IPART for making the historical data on retailers' published offers on electricity and gas since 2020 (**Data Set**) available. We have found the examination of this data a worthwhile exercise and hope it can provide IPART with further valuable feedback of the maximum price methodology.

After reviewing the data, we suggest that further guidance would be required as to what offers are/are not included in IPART's methodology and suggest that all included offers would need to follow the same tariff structure. At present, we can see a number of anomalies in the data set used by IPART as follows:

- The Data Set contains offers from retailers that are not comparable to those offering a standard retail product. For example, Amber offers a spot price pass-through product to customers, however on Energy Made Easy their offer is an estimated price based on historic spot price outcomes and is not reflective of what the customer may actually end up paying. We think that even including Energy Locals in the data set when assessing the median of daily supply charges and usage rates is inappropriate. In its retail market offers, Energy Locals makes no margin on those two components, instead showing its margin transparently in a membership fee. This charge would not form part of daily charge and usage analysis and therefore artificially drags down the median.
- In addition to the inclusion of incomparable retailers, we are also concerned that the Data Set includes offers that are not 'generally available' and therefore should not be included in any maximum price calculation. In 2019, the Essential Services Commission of Victoria (**ESC**) introduced a requirement for energy retailers to tell their Victorian customers whether they are on the best energy plan. The calculation for determining whether a customer is on the retailer's 'best offer' is well established and includes the concept of 'generally available' and 'restricted' offers. Restricted offers are any plans specifically targeted to an exclusive individual or group and tailored to the specific circumstances of the customer and their needs and is not included in the best offer calculation. The same logic should be applied to IPART's proposed maximum price calculation and restricted offers, including those only available to new customers, should be removed from the Data Set. Examples include offers that are designed to target EV owners, solar PV owners, battery customers, people over a certain age, and customers who are members or employees of certain organisations.
- The inclusion of conditional discounts in the methodology does not reflect the prices that retailers offering the plans may actually charge the customer. The ACCC Market Report released in December 2023 provides that 96% of residential customers on plans with an unconditional price more than 25% above the default offer were on a plan with a conditional discount in 2023.[17] The ACCC acknowledges that high conditional discounts are usually attached to an inflated underlying price and that their "most recent billing data shows that non-achievement of conditional discounts continues, with almost a quarter of hardship customers failing to achieve their conditional discounts for the third quarter of September 2022"[18]. In light of the above, it is clearly inappropriate to include conditional discounts in the methodology for calculating a maximum price.

[17] Australian Competition and Consumer Commission, *'Inquiry into the National Electricity Market – December 2023 Report'*, P. 6

[18] Ibid

- The methodology proposed by IPART for calculating the maximum price appears to involve taking the lowest consumption charge and lowest daily supply charge from each retailer to calculate two separate medians, even if those two amounts do not comprise the same offer. For example, a retailer may be able to offer a low daily supply charge because it is subsidised by a higher consumption charge, or vice versa. This does not result in a true reflection of the lowest offer in market from each retailer.

d) Snapshot method not appropriate

IPART has recommended that adjusting the maximum price every six months will improve responsiveness to cost changes and that the maximum price be based on market offers in the preceding month. Such an approach will not provide embedded network retailers with adequate opportunity to engage in hedging strategies to manage the risk of price fluctuations in the wholesale market. It does not account for embedded network retailers' efforts to secure energy cost price stability through long-term contracts or maintain a reasonable book build period that includes available trades on the ASX. This approach would increase business risk and is not consistent with the hedging alignment provided to non-embedded network retailers under the AER's annual DMO price determination methodology.

In addition to incompatibility with hedging strategies, basing maximum prices on market offers at a snapshot in time may capture an incomplete market picture. Prices in the market are influenced by multiple factors that may not be adequately captured in a single month. There is also a risk our competitors might exploit the system by strategically lowering prices in a specific month to influence the benchmark and gain competitive advantage.

7. Maximum price methodology for hot water

IPART's draft methodology for hot water maximum prices is based on the gas price benchmark and the application of a maximum common conversion factor of 0.4MJ/L. IPART is also proposing to prevent embedded network owner/operators from charging an additional supply charge for hot water services.

We submit that this approach is flawed and overly simplistic because:

- it does not enable embedded network operators to recover the costs of the infrastructure installed on the sites, including hot water meters and centralised hot water plants; and
- applying a common conversion factor assumes that all hot water systems are the same, which they are not;
- it assumes that environmental conditions are the same across the entire State year-round, which they are not;
- IPART's analysis set-out in Table 5.1 of the Draft Report (hot water costs for on-market customers) does not include a daily supply charge that is commonly charged by retailers. For example, the gas type of hot water system only includes a 3.2 c/MJ consumption charge. The exclusion in the comparison of the daily supply charge renders the analysis incomplete and possibly misleading;
- the conversion factor will vary depending on the number of people that are consuming hot water in the building. This factor is usually calculated as an average of energy consumed to heat the water plant and the number of hot water consumers in the building. The boiler will consume the same amount of energy to maintain the water heated at a predetermined temperature and that cost will be divided in the number of hot water consumers. Therefore,

each unit may pay a higher price if there is a low rate of occupancy in the building for that billing period; and

- the 0.4MJ/L benchmark relates to the certification of new centralised hot water systems and does not consider the likely lower efficiency of legacy systems still in service installed in previous years (a principle acknowledged in your report under section 5.3.3).

We have elaborated on this below.

a) *Applying a common conversion factor*

Energy Locals foresees challenges with the use of a general conversion factor as it would not consider that embedded network sites are different sizes and the hot water plants are different models and ages. For example, [redacted] Plants under our management could be gas-only, electric, electric heat pump, or solar-powered with supplementary electric or gas heating. In addition, the local environment, including the ambient air and water temperatures and quality of building insulation, impacts on efficiency of the hot water plant and applicable conversion factor for heating water. The ongoing heating costs of modern heat pumps can be half the cost of less efficient gas plants per apartment, which will offset the higher upfront costs over time if the same party installs and operates the equipment.

b) *Recovery of hot water plant costs*

We understand that IPART believes that introducing a maximum hot water price based on gas and removing the daily supply charge could provide an incentive for sites to utilise more efficient systems, such as electric heat pumps because they have lower operational costs. We respectfully disagree. While we endeavour to install the most efficient infrastructure available for our clients and customers, in some cases we are precluded from doing so by physical space restrictions, cost or the wishes of our client.

[redacted]

c) *Consequences of the proposed maximum price*

Energy Locals have reviewed the impact of the proposed removal of the daily supply charge for hot water sites across sites that have been operational for at least the last 12 months [redacted]

If embedded network owner/operators are unable to recover hot water plant costs through customer tariffs (or by other means), embedded network owner/operators would likely have no choice but to:

- in the cases of existing embedded networks which are rendered commercially unfeasible:
  - require the OC to purchase the embedded network equipment or remove that equipment from site (both options being disruptive to the OC, owner occupiers and [redacted]

tenants and resulting in potentially hundreds or even thousands of embedded network sites seeing cessation of hot water services impacting a large number of residents); or

- refrain from investing in infrastructure during the development phase which would likely result in developers installing less efficient equipment, which would ultimately lead to higher bills for customers in the future anyway; or
- cease contributing to maintenance and replacement costs, of which owners' corporations would then be responsible for, and

- for new developments, developers would be incentivised to add cheaper, gas-based, and less efficient hot water systems. Given that these systems would likely not be financially viable to run due to the common factor conversion rate, a rational embedded operator would offer to provide a billing service to the OC. The OC would be left having to cover the cost between the hot water price cap and the cost to operate and maintain the system. This would flow to owner occupiers and then to tenants through rent increases.

It is important to note that, if embedded network operators are not installing equipment on site, then the long-term design efficiencies of embedded network operators would also disappear. It is also likely that new apartments would increasingly move to decentralised hot water which is less efficient and imposes a material impact on usable space within apartments.

8. Consumer protections

We understand that the Australian Energy Regulator (**AER**) and IPART believe that embedded network customer protections are compromised due to gaps in the regulatory framework and lack of transparency. To combat this, IPART has proposed a complaints-based framework, under which IPART and the AER investigate potential breaches identified and reported by the NSW Ombudsman.

We submit that the lack of transparency in the embedded network space is a result of embedded network sellers being able to operate 'under the radar' due to the current 'hands-off' approach of the exemptions guideline. While we understand that the AER is currently reviewing these guidelines, we reiterate that customers will be best protected if supplied by a licensed retailer under the retail authorisation (not under a retail exemption) who is subject to all reporting and regulatory requirements set out in the National Energy Retail Law. All Energy Locals' embedded network electricity customers are contracted via our full retail authorisation.

9. Requests for further clarity

a) Potential conflicts between regulatory roles of AER and IPART

IPART's draft recommendation is that it be the regulator to both determine, and enforce compliance with, maximum prices for the sale of electricity, gas and hot/chilled water to embedded network customers in New South Wales. Under the NECF, the AER already has several functions in relation to embedded networks. These include governing who can sell energy in, and operate, embedded networks without a retail authorisation or registering as a network service provider, and the conditions with which such persons must comply. The AER is also responsible for determining the default market offer (DMO) each year and setting an upper limit on how much authorised retailer can charge (though this price protection is not

necessarily extended to embedded network customers). Enforcing compliance with these matters is also within the AER's remit.

Legislating a new role for IPART in relation to embedded networks, either under the NECF or NSW-specific laws, will need to account for the existing role of the AER and address any conflicting powers or mandates between the State and Commonwealth regulator. Challenges, and compliance burdens, are likely to arise where there is a growing lack of consistency as between the NECF and state-specific regulatory frameworks for embedded networks.

The risk of increased inconsistency in the embedded networks regulatory framework is heightened in the context of the following (which are occurring simultaneously with IPART's investigation):

- the AER's review of consumer protections for future energy services. As part of this, the AER has provided final advice to Energy Ministers that includes the challenges of embedded networks, how embedded networks will interact with new energy products and services, and what changes to the regulatory framework may be needed to address potential consumer harms.[19] In the advice, the AER also notes that it is undertaking separate processes to address potential challenges with embedded networks (including its forthcoming review of retail exempt selling guideline and network exemptions guideline);
- the Commonwealth Department of Climate Change, Energy, the Environment and Water's (**DCCEEW**) consultation on how to extend price protections provided by the DMO to customers in embedded networks. Public consultation occurred earlier this year, but the DCCEEW is yet to indicate next steps and/or outcomes in this process[20];
- the new embedded network tariffs proposed by Ausgrid and Endeavour Energy in their 2024-29 Regulatory Proposals, which the AER is currently considering.

The AER noted these potentially overlapping reviews and consultations in its submission on IPART's draft Terms of Reference for its investigation of NSW embedded networks.[21] This highlights that legislating equitable treatment of, and clear and consistent obligations for, embedded network providers across jurisdictions is a live challenge for the regulators and a significant cause for concern for those affected by the outcomes.

b) Retrospective application of draft recommendations

The Draft Report is silent on how the proposed pricing methodologies are to be applied to existing embedded networks. If the proposed pricing methodologies are applied retrospectively to existing networks, their implementation will drastically affect the ability of the embedded network industry to continue to support customers. As demonstrated in Part 6 of this submission, it would, in many circumstances, render current networks commercially unfeasible.

[19] See: Report template (aer.gov.au)
[20] See: Consultation hub | Consultation on implementation of 2022 Default Market Offer review outcomes - Climate (dcceew.gov.au)
[21] See: AER submission - IPART EN review - 17 April 2023.pdf

This would have vastly detrimental effects on our customers, building owners and embedded network suppliers.

We respectfully request that IPART consider how the proposed pricing methodologies will be applied, if at all, to existing networks and provide further clarity in its final report to the New South Wales Government.

In summary, Energy Locals appreciates the opportunity to provide this submission which has aimed to highlight the complexities and potential consequences associated with the recommended pricing objectives, particularly emphasising the potential drawbacks of re-pricing embedded network tariffs every six months and benchmarking prices to the median of the lowest market offers. We believe that such approaches may create undue stress for customers, hinder innovation, and lead to a lack of price and service predictability.

Our submission underscores the importance of striking a balance between customer protections and fostering an environment conducive to growth, innovation, and affordability in the embedded network sector. We have provided detailed insights into our business operations, contracting structures and the lifecycle support we offer to both greenfield and existing sites, including providing all equipment at no upfront cost to the building owner. We have also addressed concerns regarding the recovery of infrastructure costs, foreseeing potential challenges in aligning with existing agreements and emphasising the critical role of embedded network operators in facilitating access to sustainable energy solutions and fostering innovation.

We urge IPART to carefully consider the potential consequences on access to sustainable energy solutions and housing development costs. Energy Locals remains committed to collaborative engagement and looks forward to regulatory measures that serve the best interests of embedded network customers, promote sustainability, and contribute positively to the broader energy landscape.

Thank you for considering our submission.

Yours faithfully,

Adrian Merrick

Chief Executive Officer

Energy Locals Pty Ltd