



EnergyAustralia

LIGHT THE WAY

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Draft Decision Energy Prices in embedded networks
Independent Pricing and Regulatory Tribunal NSW
Lodged electronically via IPART portal

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Draft Decision: Energy Prices in embedded networks

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. EnergyAustralia owns, contracts, and operates a diversified energy generation portfolio that includes coal, gas, battery storage, demand response, solar, and wind assets. Combined, these assets comprise more than 5,000 MW of generation capacity.

EnergyAustralia appreciates the opportunity to provide a submission to the Independent Pricing and Regulatory Tribunal (IPART) draft decision on prices in NSW embedded networks. We appreciate that IPART have considered our feedback and reflected some of these in the draft decision. Our submission raises questions on whether IPART have struck a reasonable balance in its proposed pricing approach. In our view, there are important considerations that IPART should reexamine in its draft recommendations and details that need further clarity. We have particular concerns with:

- setting 6-month price adjustments and the proposal to use on-market offers from one month, which will not reap the considered benefits, may not be reflective of true supply costs and can leave consumers worse off. We recommend an annual price setting which has advantages including some regulatory consistency with other decisions (i.e. DMO/VDO) and mitigates the pitfalls of a 6-month approach such as timing and seasonality impacts.
- prohibiting a fixed supply charge on embedded network hot water and heating/cooling services, which runs the risk of going too far and could lead to detrimental unintended impacts. The commercial outcomes from this recommendation could see most, if not all providers ceasing supply of services to many buildings or even exiting the broader market.

Our full submission and responses to the consultation questions are below in the attached.

If you have any questions in relation to our submission, please contact me

Regards,
Maria Ducusin
Regulatory Affairs Lead

Six-month price adjustments will not reap considered benefits

IPART recommends a 6 month-price setting when adjusting maximum prices:

Our draft recommendation is to adjust prices every 6 months. While this would impose a greater regulatory and administrative burden, we consider it is the most effective way of ensuring the pricing methodology is responsive to volatile cost changes while maintaining a reasonable level of price stability for customers.¹

IPART proposes a 6-monthly price adjustment based on offers taken from one month, stating:

the following time schedules for the release of new maximum prices

- maximum price from 1 August to 31 January: using market offers taken in July
- maximum price from 1 February to 31 July: using market offers taken in January.²

IPART should clarify whether the proposed approach is intended to reflect on-market offers based on the entire one month of July and January, or for one day of the month in July and January. We gather it may be the latter given there's a reference to a 'benchmark day' in the draft decision.

In explaining the approach to benchmark to the median of the lowest tariffs, IPART notes:

In calculating the median lowest offer, our draft recommendation is to only include retailers with more than 1000 customers ('active retailers') that have an active offer available **on the benchmark day**. This:

- ensures that all relevant market offers that may be taken up by on-market customers are used to calculate the median, including those from smaller retailers
- provides a safeguard against retailers setting up subsidiary retail operations intended to influence the price cap (but may not supply many customers).³

We have strong concerns with:

- the recommended 6-month price adjustments
- the proposal to use on-market offers from one month to set the maximum prices for the 6-month period
- the proposal to use on-market offers from retailers with more than 1000 customers, which still faces pitfalls.

In our view, the rationale for 6-month updates does not hold. Adjusting prices every 6 months based on generally available retail offers (on-market offers) does not mean the pricing methodology is more responsive to cost changes. On-market pricing *can* reflect standard mass-market retailer cost stacks (if looking at a sufficiently long-time horizon) but may not accurately reflect the costs faced by embedded network service providers. For example, the pricing dynamics in the retail market with tier 1 and tier 2 retailers in a 6-month period based on a one-month snapshot does not reflect how embedded network

¹ IPART, *Embedded Networks Draft Report*, December 2023, p 49.

² IPART, *Embedded Networks Draft Report*, December 2023, p 49.

³ IPART, *Embedded Networks Draft Report*, December 2023, p 43.

service providers procure wholesale energy, which is done on a longer-term basis such as 2 to 3-years.

Second, we have strong concerns with using on-market offers from one month: July and January to set maximum prices for the 6-month periods. Tier 1 and tier 2 retailer price campaigns to attract new customers can last several months. A benchmarking approach based on offers in one-month may not be reflective of the true cost of supply. If July or January overlaps with retailer price campaigns this could see more reduced lowest median prices than other months that fall outside the timing of retailer campaigns. Also, this approach may incentivise non-embedded network retailers to strategically time their on-market pricing updates to lower the regulated embedded network prices, disadvantaging competing retailers that supply embedded networks. The risk of both of these events occurring would be higher if IPART adopts a 'benchmark day' in the month.

A rolling 6-month average would be a more sensible approach.

Given the above, we do not consider that using on-market offers from one month to set 6-month price updates will mean the methodology is responsive to cost changes – particularly those faced by embedded network service providers.

A general reduction in retail prices in a 6-month update may be needlessly squeezing margin from embedded network service providers without a realised benefit. In an environment concerned with the cost of living, we question whether there would be an equivalent expectation that a rise in retail prices would see an increase in the 6-month maximum price.

In our view, restricting the allowable fluctuations in price on a 6-month basis could have other negative unintended consequences, including:

- Entrenching competitive advantages of existing large, embedded network incumbents who are better able to endure fluctuations in price and frequency of updates compared to smaller embedded network sellers [REDACTED]
- Discouraging embedded network service providers to invest in ways that create value for consumers. Restricting allowable price fluctuations on a 6-month-basis runs the risk that embedded network service providers do not invest in efficient equipment or services and displaces these roles to developers or other parties leading to less efficient solutions and worse consumer outcomes.
- Squeezing allowable margin may deter new entrants to be an embedded network service provider or sees existing players cease to provide services to buildings or exit the broader market, reducing competition in the long term.

Further, we consider the proposal to use on-market offers from retailers with more than 1000 customers, still faces pitfalls:

- These smaller retailers may not provide services for embedded networks so relying on this approach may ignore the true cost of supply.
- These smaller retailers can offer very low market offers to attract new customers, below the cost of supply, so relying on this approach runs the risk that embedded network suppliers cannot recover their efficient costs.

The risk of the above can be greater if IPART adopts a 'benchmark day' approach which will be more sensitive to timing impacts.

IPART could explore using on-market offers only from retailers that also provide services for embedded networks.

We recommend an annual price which mitigates pitfalls of 6-month updates

While a rolling 6-month average would be more sensible than IPART's proposal, given the criticisms with a 6-month approach, we strongly recommend an annual price setting which can have advantages - including:

- Maintaining the benefit of some regulatory consistency with other pricing regulation (i.e DMO/VDO decisions). Some regulatory consistency can help maintain retailers' confidence that they can recover their costs.
- Mitigating seasonality and timing impacts that can arise from the proposed 6-month approach.
- Mitigating pitfalls of the proposed 6-month approach that is likely to have no realised benefit of being responsive to retailer cost changes and can have detrimental unintended consequences.

Banning a fixed supply charge runs the risk of worse consumer outcomes

We have strong concerns with prohibiting a daily service charge from the following embedded network services, and discuss each in turn:

- gas hot water
- electric hot water
- heating and cooling.

Gas hot water

IPART has recommended 'no additional supply charge would be allowed for hot water services'⁴ because 'on-market customers, who do not have controlled loads, do not incur separate supply charges for the energy used to heat hot water, through their electricity bills'.⁵

The draft decision goes on to explain the reasoning behind prescribing a common factor in setting a maximum hot water price:

We propose to prescribe a common factor as part of our draft methodology to ensure that customers do not bear the costs of system inefficiencies, which are outside of their control. We understand that inefficient systems have been the main driver of very high hot water bills for some customers.⁶

For gas, we consider that banning a daily service charge and relying on a gas common factor to set maximum prices based on system efficiency ignores the true running cost to supply. The fixed charge can reflect the cost to install and maintain software systems to provide consumer-centric services to embedded network customers. If embedded network service providers are forced to run at a loss, they could stop servicing the building or exit the broader market, leaving consumers worse off.

Removing a provider's ability to recover their infrastructure and maintenance costs through a daily service charge is problematic and should be overturned. Operators may

⁴ IPART, *Embedded Networks Draft Report*, December 2023, Maximum pricing methodology for hot water, p 54.

⁵ IPART, *Embedded Networks Draft Report*, December 2023, Maximum pricing methodology for hot water, p 61.

⁶ IPART, *Embedded Networks Draft Report*, December 2023, Maximum pricing methodology for hot water, p 53.

invest often up to \$1 million per building in equipment and system services. An inability to recover this cost could displace these roles to developers or other parties leading to less efficient solutions and worse consumer outcomes.

If this IPART recommendation is adopted, we may need to consider ceasing to provide these consumer-centric services if they are not financially viable. This may mean residents would no longer receive user-pay bills as this service is not captured by standard embedded network configurations but accessible only because of proprietary-based software that embedded network sellers invest in to support the provision of user-pay charges to customers. Residents of embedded networks could see regression to historic approaches that split bills via fees based on lot liability or other sub-optimal consumer outcomes.

In prioritising the objective to ensure embedded network customers are not paying more than non-embedded network customers, prohibiting a daily supply charge for gas hot water services runs the risk of going too far as it can undermine several competing IPART objectives to:

- ensure an embedded network seller is able to recover its efficient costs of supply
- allow for cost reflective pricing
- incentivise embedded network sellers to supply and use energy efficiently and enable the efficient use of energy
- encourage sustainable energy solutions and accommodate innovation and investment in the energy sector.

Electric hot water systems

We have the same concerns noted for gas as we do for electric hot water systems. IPART recognises the benefits of electric hot water systems noting they 'can be provided at significantly lower life-cycle cost compared [to] centralised gas systems.' However, the draft decision appears to ignore the fact that the average capital cost of an electric hot water systems can be 3 times more than that of gas. The proposal to prohibit a daily service charge for hot water services could discourage future installations of electric hot water systems due to cost, regressing back to gas. This undermines objectives to encourage sustainable energy solutions and innovation that IPART and government policy is trying to achieve. Regression to gas also undermines objectives to reduce carbon emissions.

IPART should consider grandfathering provisions. If a business recently invested in costly electric and gas hot water systems based on the current market and regulatory environment, then they should not be penalised by new requirements which can restrict them from recovering this cost. Grandfathering provisions would allow businesses a reasonable grace period to comply with new regulations. Well-designed grandfathering provisions can ensure a smooth transition towards stricter regulations (for example, no gas hot water services in new developments) without jeopardising existing investments that have benefited residents of embedded networks.

Heating and cooling charges

Like hot water, we provide services that support customers paying for their actual usage rather than using historic approaches that split lot liability via fees. Given that these

units are not individually metered, suppliers must seek data from the manufacturer's proprietary software at our cost. Given our methodology is to charge energy units at the same price as energy through a traditional meter, removing the ability to recover costs through a daily service charge could lead to worse customer outcomes as discussed above.

Below are issues that we consider require further clarity:

- **Whether IPART's recommendations is intended to cover on-market customers in embedded networks in NSW.** It is not clear to us from the draft decision if this is the case. We would expect that on-market customers in an embedded network would not be included as on these customers can participate in retail competition. Recent regulation introduced Embedded Network Managers to facilitate competition, which is the most appropriate mechanism to generate strong customer outcomes. Including on-market customers in direct price regulation would undermine the intent of existing regulation aimed to encourage customers to go on-market. Our previous submission discussed how setting a different regulated price can distort the market and result in worse outcomes for embedded network customers already participating in the retail market.
- **Whether unmetered gas or gas cooktop supply is covered under the proposed gas price settings.** It is unclear to us from the draft decision if this is the case. The NSW parliamentary committee appeared more concerned that centralised hot water services fuelled by gas was unregulated by the NECF/AER framework noting that the AER considered the sale of bulk chilled or hot water was unlikely to constitute the sale of energy for the purposes of the retail law. As we raised in a previous submission, the anecdotal evidence received by the NSW parliamentary committee showed excessively high prices for hot water, not gas services like stovetop gas. There does not seem to be sufficient evidence to demonstrate that there is a "price gouging" issue for gas cooktop supply to substantiate regulation. Implementing direct price regulation before a rigorous cost-benefit analysis presents as regulatory overreach and a solution in search of the problem.
- **How the existing regulatory framework will fit into IPART's draft recommendations.** There is still more detail that needs to be worked through to understand this question and how varying businesses will be impacted by IPART's recommendations. The NSW parliamentary committee noted the operation and selling of energy in embedded networks by different entities means that customers receive different levels of consumer protections under different regulatory frameworks. This was depicted by the table below:

Embedded networks – entities & consumer frameworks				
Electricity on-seller			Embedded network owner/operator	
Type of entity	Authorised energy retailer	Exemption holder	Authorised energy retailer	Exemption holder
Consumer protection framework	National Energy Retail Law (NERL) & National Energy Retail Rules (NERR)	AER Exempt selling guideline	AER Exempt Network guideline	AER Exempt Network guideline

Source: EWON, Presentation, 3 August 2022, p 27.

However, if a business is an authorised retailer and also holds an exemption for embedded network sites – it is unclear to us how IPART’s recommendations and who is intended to be covered under the proposed regulatory regime will fit into the existing regulatory framework.

- How will the cost of imposing a new compliance system be recovered.** IPART may be burdened with higher cost and resources from a rise in customer complaints - how is IPART proposing this cost be recovered? Via the state budget? Will the cost be charged to the embedded network operator or allowed to pass through in retail pricing to mass market customers? In Victoria, a fee is charged to retailers and the ESC (Essential Services Commission) allows for this fee in the VDO (Victorian Default Offer) cost stack.

Consultation questions

[Redacted]

- 1. Are embedded network sellers currently using time-of-use tariffs, demand tariffs or any other innovative tariff design?**

[Redacted]

- 2. How are embedded network sellers charging for electric vehicle charging at the site? What are the prices?**

[Redacted]

[Redacted]

[Redacted]

We recognise that the NSW parliamentary committee reported a potential issue with electric vehicle charging noting:

The lack of disclosure around embedded network services is concerning, and it is vital that the NSW Government ensures that embedded network businesses do not exploit the rise of electric vehicle infrastructure being installed and operated in strata complexes.⁷

The report later highlighted that disclosure is not going to solve all problems. For example, where customers are threatened to be disconnected because they have not paid one element of their embedded network service bill.

Rigorous analysis, coupled with stakeholder consultation is critical to ensure regulatory measures on EV charging are well-targeted, effective and minimise unintended consequences for consumers and industry.

Similar to the case of unmetered gas cooktop supply, we would encourage IPART to undertake an examination of consumer harm arising from EV charging service practices and a cost-benefit analysis of regulation before deciding whether direct price regulation of these services would deliver better customer outcomes. Until evidence-based analysis demonstrates a need for direct-price regulation, we would expect EV charge pricing be governed by market dynamics, as this is the most effective mechanism to delivering good consumer outcomes.

3. Would a complaints-based compliance system deliver the right level of consumer protection?

The question of balance is also one of costs versus benefits. As discussed above, we consider further clarity is required to understand how the cost of imposing a new compliance system will be recovered.

Further, to mitigate the regulatory cost of a new compliance system, it may be worthwhile establishing clear criteria of when IPART can investigate and request information from business. Information requests increases regulatory costs, and this is ultimately borne by consumers. Having a clear and transparent trigger threshold can help limit the volume of information requests to significant or egregious cases. This would help mitigate regulatory burden and cost that business (and ultimately consumers) face, as well as help protect consumers from egregious behaviour.

As we understand it, the Energy and Water NSW Ombudsman already has existing roles related to consumer complaints and investigation. Examining overlap in functions between IPART and the ombudsman and how to best address these will also go some way in realising benefits in consumer protection through new requirements.

4. Should new non-centralised hot water embedded networks be banned?

⁷ [Report - Embedded Networks in New South Wales.pdf \(nsw.gov.au\)](#), p34.

Individual hot water units for each embedded network dwelling may not be commercially feasible or feasible considering space and safety constraints. However, it is unclear whether this is or will always be the case. As reflected in previous submissions an outright ban may potentially be a very blunt, short sighted policy response. We have a more nuanced position regarding new gas hot water systems in new developments.

5. Should embedded networks using gas hot water systems be prohibited in new developments?

EnergyAustralia supports electrification as the primary lowest-cost pathway to lower emissions (net zero by 2050). Reducing dependence on gas in new residential embedded network developments will help meet our decarbonisation objectives. As we have stated in other consultations on gas reform, deferring commitment to electrification creates the risk of 'locking in' gas assets and associated emissions. With this in mind, we consider the merits in banning gas hot water systems in new embedded network residential developments. However, as we mentioned, electric hot water systems can be 3 times more expensive than that of gas. Restricting the ability for sellers to recover costs by removing a daily supply charge from hot water services runs the risk that sellers will be unable to recover their costs. This is a credible risk as IPART is proposing a lower price than the DMO that incorporates a 'buffer' or headroom. A near term solution could be to continue to allow for a daily supply charge for hot water services and provide for a transition pathway for removal.