The Future of Embedded Networks in NSW
Independent Pricing and Regulatory Tribunal (IPART)
PO Box K35
Haymarket Post Shop, Sydney NSW 1240

To Whom It May Concern

Submission on IPART's Draft Report – Embedded Networks – December 2023

The Shopping Centre Council of Australia (SCCA) welcomes the opportunity to comment on the Independent Pricing and Regulatory Tribunal of NSW's (IPART's) *Draft Report – Embedded Networks – December 2023*.

Put simply and respectfully, we don't have confidence with IPART's understanding of non-residential embedded networks (ENs) and the AER framework (and how it applies); or that any genuine or substantiated problems, failures or harms have been identified in relation to non-residential ENs. In this regard, we submit that IPART is not in a position to make credible claims or any credible recommendations in relation to NSW-specific (or other) policy in relation to non-residential ENs.

As a simple example, IPART's comments in relation to the DMO and ENs do not line up with evidence or reality. **One hundred percent (100%) of business customers from sampled SCCA member ENs are on contracts that are below the DMO, and they are on average 3 times lower than the volume weighted average retail market outcomes shown in ACCC data noted in this submission.**

We have a longstanding active engagement on EN policy and regulation including with the AER, AEMO and the AEMC, which we have approached in good faith and with a deep understanding and experience on regulatory and market issues. For instance, we were involved when the AER framework was first developed and have been involved in every review and policy change since. Where genuine problems have been raised, we have helped develop and support policy change including to ensure that the implementation of such change is done properly, efficiently and with integrity.

Our headline concern is that IPART has little to no basis in relation to its key commentary on non-residential ENs in its Draft Report. This includes commentary in relation to customers, the recovery of costs and the adequacy and adequacy and application of the DMO. Other commentary in the Draft Report (e.g. in relation to previous reviews) appears selective, incomplete or not properly contextualised including where subsequent actions that have taken place.

In one case, a legally false statement is made in the Draft Report, which demonstrates a poor understanding by IPART of the current AER framework, other laws and EN operational issues.

IPART has not identified any specific or substantiated regulatory or market failures in relation to non-residential ENs.

Upon asking in discussions, IPART confirmed to us that no specific representations have been made in relation to non-residential EN failure. This follows a previous assurance to us that the review was focussed on residential EN issues (where the identified issues were); and not on non-residential. Instead of any specific issues being raised, generic claims and queries have since been put to us based on high-level policy principle or perceived issues (versus specific problems, harms or failures); none of which reasonably justify any policy intervention.

It seems IPART may have fallen into a trap – which we have seen before - whereby identified issues in relation to residential ENs have simply been transferred as being issues in non-residential ENs.

The shopping centre EN market is different to residential ENs in several distinct ways, and common residential EN issues are certainly not automatic issues in non-residential ENs; notwithstanding that our tenants (and EN customers) are in leasehold premises versus freehold premises, and that we are in a business to business environment.

It is therefore incredibly disappointing that we now have the burden of 'disproving' generic claims on certain issues or why policy intervention isn't justified (including the need to provide this submission), which does not give us a lot of confidence in IPART's approach, analysis or process.

Further, it is frustrating that IPART's Draft Report, in selectively referencing the SCCA submission, could give the false impression that IPART has engaged deeply with us or our industry.

Much of IPART's commentary is also in contrast to the actions identified in the *NSW Embedded Network Action Plan* including (but not limited to) that the NSW Government continue advocacy to the AER (versus, coming up with new proposals outside the AER framework).

We submit the following key recommendations for IPART's consideration:

- **Recognise the benefits of ENs for shopping centre EN customers and tenants, including the higher level of service they provide to their customers, and a proper recognition how the EN market operates in practice and that the AER framework is the appropriate regulatory framework.**
- **Acknowledge and remove incorrect statements contained in the Draft Report, in any Final Report, including in relation to the AER framework and commercial EN cost recovery,** including noting that NSW shopping centres are forbidden by law (*NSW Retail Leases Act 1994*) from recovering capital costs from tenants and any statements to the contrary would leave readers with an inaccurate view.
- **Remove unsubstantiated comments in relation to IPART's 'view' on the DMO in the Final Report, noting that this was not based on any clear evidence or analysis.**
- **Do not make any recommendations in relation to the regulation of non-residential ENs.**
- **Do not make any recommendations that would affect the Default Market Offer (DMO) price cap for shopping centre ENs**, as it remains a robust, accurate, effective and efficient mechanism and has proven to provide effective outcomes for EN customers. If there are any issues in relation to the DMO (e.g. how licensed retailers make offers to EN customers), that needs to be properly articulated and progressed via the AER framework.
- **Do not undermine the effective, national EN framework for non-residential ENs under the AER framework, which contains effective price regulation (noting this does not apply to retailers making offers to EN customers) and continues to be the subject of review and change when needed. The NSW Government should instead raise relevant issues with the AER, consistent with the NSW Embedded Network Action Plan, and including through the current AER** *Review of the AER exemptions framework for embedded networks*.

- **If there are genuine and substantiated issues with residential ENs (as was, for instance, the focus of the previous NSW Parliamentary Inquiry) focus on those issues rather than simply transferring any such issues to non-residential ENs.**
- **If any failures are identified with how licensed retailers and traditional energy companies engage with ENs, focus on that sector rather than making ENs being unfairly responsible.**

This submission is provided in good faith, and we would welcome the opportunity to discuss the review with IPART officials, Tribunal members and the NSW Government. Attachment 1 of this submission provides further analysis and information, including independent external observations, analysis and advice commissioned by the SCCA. As part any further discussions, we would be happy to discuss the background and other material relevant to this submission as part of a genuine and trusted dialogue.

Yours sincerely

Angus Nardi

Chief Executive

ATTACHMENT 1 – SCCA Further Response to IPART's Draft Report

COMPLIANCE STATEMENT - *COMPETITION AND CONSUMER ACT 2010*

In preparing this submission including the consideration of relevant SCCA member data and information, the SCCA has taken steps to ensure that it is not contravening the spirit, intent or application of the *Competition and Consumer Act 2010*, including by engaging in or facilitating any conduct or behaviour that is anti-competitive or would substantially lessen competition, including through collusion, cartel conduct or by engaging in a concerted practice. This includes that the SCCA did not act, and will not be acting, as an intermediary for the communication of commercially sensitive information between members and/or competitors. Nor will the SCCA be using or enabling the use, by its members, of the information collected in ways as might replace or reduce competitive, independent decision making by shopping centre owners including as embedded network owners and operators.

EXECUTIVE SUMMARY

DEFAULT MARKET OFFER (DMO)

As part of their review on how pricing could be set for ENs, in its Draft Report IPART has proposed a new price control methodology, recommending that maximum prices in ENs be set by benchmarking them to the median of retailers' lowest offers advertised on the AER's *Energy Made Easy* (EME) website by retailers of significance (i.e., more than 1,000 customers), every 6 months.

This includes a comment that IPART has a 'view' that 'small business customers in embedded networks would benefit from price regulation'.

IPART's position is that the DMO is not an appropriate maximum price for EN customers as it is higher than most offers available from retailers for non-EN customers. Other reasons given include that the DMO includes costs that are not appropriate for ENs - e.g. for competitive activity, and outside of energy costs.

OUR KEY CONCERNS

IPART has provide no reasoning, let alone substantive reasoning, as to why it has formed a 'view' that 'small business customers in embedded networks would benefit from price regulation'.

Firstly, through our ongoing discussions it has become clear that IPART does not fully understand what 'small business customers' are within ENs, including the nature of those businesses or the profile of small energy versus large energy customers. It seems that information on such issues not underpin IPART's view.

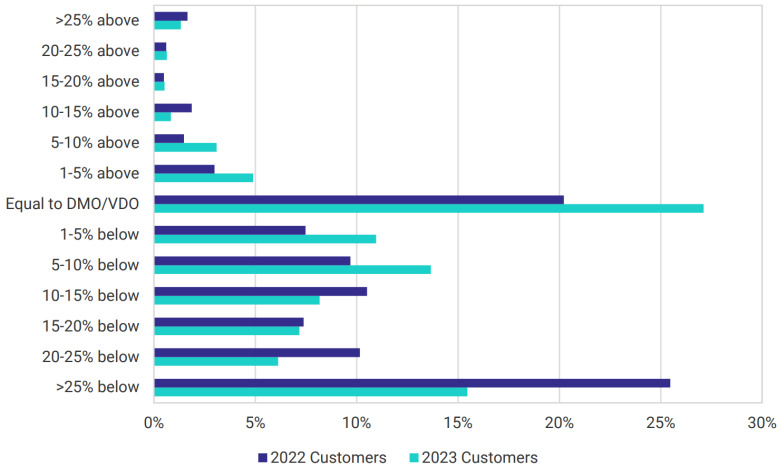
Secondly, IPART's view fails to acknowledge that the current AER framework does in fact provide price regulation – being a price cap with reference to the DMO.

Thirdly, IPART's view fails to understand the application of pricing for small business customers within ENs in light of the long-established AER framework (analysis is provided further below). Further, IPART's view failed to demonstrated any failure of the AER framework including in light of our analysis below.

The current approach under the AER framework (including with reference to the DMO) is the most appropriate price control metric due to its foundation in a transparent, bottom-up build of full economic costs at the retail level, and its relative price stability. Evidence we provide below in this attachment shows that it is also much more closely related to the market average than the analysis that IPART has relied upon.

Figure ES1 – Small Business Customer Retail Charges Relative to the DMO

Proportion of small business customers on flat rate plans paying more, equal to, or less than the DMO/VDO assuming conditional discounts are not achieved



Source: ACCC, Inquiry into the National Electricity Market, 2023, pg. 48

This contrasts with IPART's proposed method, which is not based on a detailed cost breakdown, does not provide as much price stability, or transparency as to the origins of the costs. Instead, it is influenced by short-term retailer discounts designed to capture and lock in customers. It risks market manipulation and gaming and does not guarantee efficient cost recovery for ENs.

[redacted]

The sale of electricity is not the core business of our members, and they are price takers from energy companies / electricity retailers. This is a key reason why it would be unreasonable to cap EN customer charges at the median of retail market offers, who face a different supply cost structure and sophistication. Doing so risks imposing a cost structure that is not sustainable, and one that is also not actually being realised in the retail market, with less than 37% of the small business market taking up offers lower than the median rate.

ENs are not able to manage their energy risks with the same level of sophistication as electricity retailers, and it is unreasonable to expect ENs to match the lowest supply costs offered by retailers.

RECOMMENDED WAY FORWARD

Based on our review of IPART's key inputs and assumptions, its *Pricing Objectives*, and our experience, the SCCA believes that IPART's proposed approach does not achieve its intended goals and objects, as it:

- **Will not reflect retail market outcomes** as the recommended benchmark fails to reflect what customers are actually paying. Data provided by the ACCC shows that the retail market largely reflects the DMO (Figure ES1). IPART's methodology may deliver a lower price, but one that represents a smaller fraction of the market than stated.
- **Will not ensure efficient cost recovery** as the benchmark is not based on transparent nor economically sound cost calculations, unlike the DMO. Instead, the benchmark reflects lock-in strategies by sophisticated players with sophisticated systems, large customer bases, and the ability to hedge – All things that ENs do not possess.
- **Will not deliver relative price stability** due to half-yearly benchmark updates that increase volatility for customers and opens the door for retail market manipulation.
- **Will reduce competition** due to the reducing prices below EN efficient cost of service and driving exits. Exited end consumers will be placed back in the market, double charged for LV network usage, and potentially placed on the DMO (or higher) if passive.
- **Will create additional, disproportionate regulatory costs** due to half-yearly pricing updates, requiring double the work where prices are updated annually. This will create additional costs that will ultimately be passed to EN customers for more volatile prices.

Noting the above, we hence recommend that the DMO approach remain in place as a cap for non-residential EN customers, as it is based on economically sound and transparent cost breakdowns, ensures efficient cost recovery, and is delivering better outcomes for non-residential EN customers.

We also recommend that IPART revise their incorrect statements and citation of the AER guidelines regarding capital cost recovery on pages 23-24 of the Draft Report, particularly as they conflict with NSW law which provides that shopping centre cannot recover capital costs recovery from tenants.

The SCCA believes that doing the above would help to ensure that the fundamental value created by ENs is supported, and that EN customers and operators are not unfairly worse off, including:

- Avoiding arrangements that lead to inappropriate EN loss making;
- Avoiding inappropriate exiting of ENs due to that loss making; and
- Avoiding impacts of EN customers being double charged for LV network costs and being transitioned to the DMO as passive customers.

We would be happy to provide our background information which supports this submission as part of ongoing discussions with IPART.