

**ESSENTIAL SERVICES COMMISSION: VICTORIAN DEFAULT OFFER TO APPLY FROM 1 JULY 2019 – DRAFT ADVICE (8 MARCH 2019)****COMPLIANCE STATEMENT - COMPETITION AND CONSUMER ACT 2010**

In requesting and obtaining information for the purpose of preparing this submission, 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 commercial 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**

The Shopping Centre Council of Australia (SCCA) thanks the Essential Services Commission (ESC) for the opportunity to comment on the *Draft Advice* relating to the Victorian Default Offer (VDO).

We note that the enabling *Energy Legislation Amendment (Victorian Default Offer) Bill 2019* ('the Bill') has passed the Parliament, which enables the VDO to be given effect via an Order.

Our members, as shopping centre owners and managers, own and operate embedded networks (under exemption) including the sale of energy to their tenants. The sale of energy is ancillary/incidental to their core business and, unlike residential embedded networks, comprises a business-to-business relationship and customers that can be large, international companies (i.e. they are not 'vulnerable' customers akin to residential circumstances).

We have longstanding engagement on embedded network policy and regulatory issues, including through the General Exemption Order (GEO) process, and related engagement with the Energy and Water Ombudsman Victoria (EWOV) and the ESC.

The purpose of this submission is to outline our concern with the proposed VDO in terms of its application to embedded networks, under *Clause 27 (Pricing Rule)* of the GEO. This includes our interpretation of the VDO's application, including to small customers (up to 40MWh per annum) (although we seek clarity on its application to customers greater than 40MWh per annum).

We also note the VDO is proposed to apply to embedded networks as a transitional measure, pending the development of a *Pricing Rule* as envisaged in the GEO (Clause 10) and acknowledged at page 74 of the Draft Advice.

We have several concerns with the proposed VDO, principally based on our view that embedded network issues have not been properly considered, including in the *VDO Tariff Formulae* and the cost-stack approach. In developing the VDO using licensed retailer data, we believe that the ESC has overlooked issues specific to embedded networks including the notion of 'commercial market data' under *Clause 10 (Pricing Rule)* of the GEO.

In replacing the Standing Offer, it is also implied that unlike energy retailers, embedded networks will not be able to offer rates above the VDO even if beneficial to their customers. Embedded networks are also subject to market conditions with limited ability to break or amend current contracts, or consider alternate options.

We note our concerns against the *Terms of Reference* as follows:

**...Be based on the efficient cost to run a business;**

- Some shopping centre embedded networks will run at an operating loss due to the VDO.

**...Include an allowance for maximum retail profit margin;**

- We are not comparable to licenced energy retailers, and embedded network operating issues have not been taken into consideration.

**...Include a modest allowance for customer acquisition and retention costs**

- We are not comparable to energy retailers, whereby we don't operate in the broader energy market and the principal relationship with our 'customers' is a longstanding and ongoing retail leasing relationship.

We **respectfully recommend** that the VDO is deferred specifically for shopping centre embedded networks until a later stage, to enable proper consideration as to the VDO's application, and/or to enable the ESC to start to develop a *Pricing Rule* specific to embedded networks as envisaged under the GEO (Clause 10).

Noting the estimated VDO tariffs applicable to the different distribution zones (page 74), for certain shopping centre embedded networks, the VDO will result in some networks being unviable which ultimately does not serve the network or its customers well.

In this regard, the ESC’s statement (at page 79) of the Draft Advice that ‘We note that embedded network providers could offer a price below the VDO’ will not be possible in certain embedded networks. As noted above, the VDO itself will result in an operating loss for certain networks.

**EMBEDDED NETWORK ISSUES: NOT TAKEN INTO CONSIDERATION**

Noting the above, we respectfully submit that the application to embedded networks has not been a principal consideration, or considered in appropriate detail, in preparation of the Draft Advice.

As an example, in the costing approach to develop the VDO, this includes costs being based on licensed retail businesses already operating in the Victorian market. Given that embedded networks are ancillary/incidental, limited to defined sites/assets, and have a vastly different operating environment and economies of scale, embedded network operating costs we assume are vastly different to those of energy retail businesses. In this regard, the VDO Tariff Formulae and cost-stack would not reflect embedded network circumstances.

We note that the ESC Staff Working Paper included a reference that, as an ‘Other Matter’ (i.e. we interpret this to mean not a ‘Principal Matter’) ‘the commission may need to consider in the development of the VDO...implications for the prices charged to customer in embedded networks once standing offers are abolished and replaced with the VDO’.

We also note that embedded networks were not expressly raised in the Minister’s second reading speech of the Bill.

We also note that embedded networks appear to be what could be considered an afterthought in the Draft Advice, being at the end section of the principal analysis and commentary.

We feel that policy and regulatory perspectives on embedded networks continue to be generic, including claims about embedded network customers as if they are a theoretical or non-identifiable group (see analysis below). We also believe that such perspectives are being applied to embedded network operators, as if they are akin to energy retailers, and those operating in the broader energy market, such as AGL and Origin Energy.

We are also concerned that, like our experience in other forums, there is a limited understanding of shopping centre embedded networks; including whereby most scrutiny, assumptions and concerns seem to be on residential networks (e.g. apartments, retirement villages) and their customers including those that are considered vulnerable.

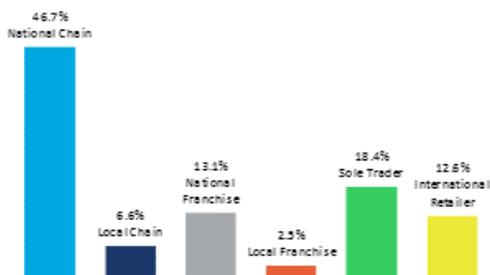
**OVERVIEW: SHOPPING CENTRE EMBEDDED NETWORKS**

Shopping centre embedded networks vary substantially, and have a vastly different relationship with their customers, compared with residential embedded networks.

Firstly, many ‘small’ energy customers in shopping centre embedded networks are in fact ‘large’ companies – in some cases being either ASX-listed or international companies.

To illustrate our ‘customer type’ – beyond simply being ‘retailers’ – the analysis below highlights that 18.4% of retailers in a typical sample shopping centre could be considered as ‘sole traders’ (i.e. owner operated, generally a single (or few) site business).

The rest are larger retailers, being national chains, international retailers and franchises – i.e. the majority by the type of retailer are not ‘small’ entities.



To further explain, the average store network for the analysis is as follows:

- National Chain – 231 stores.
- Local Chain – 10 stores
- National Franchise – 150 stores
- Local Franchise – 11 stores.
- International retailer – 195 stores (including international fast food chains).

Secondly, there is the case that even where a retailers’ individual energy bill is less than \$20,000 (e.g. EWOV’s general jurisdiction), they can hold several energy contracts across numerous shopping centres. This highlights that retailers can hold several energy contracts across the same/different shopping centres, amounting to hundreds of thousands of dollars.

## SHOPPING CENTRE EMBEDDED NETWORK PRICING

The below is provided, noting the *Compliance Statement – Competition and Consumer Act 2010* provided at the start of this submission.

As the ESC is aware, under the GEO (and similar to the *AER Retail Exemption Guidelines* – but also noting that the AER’s *Network Exemption Guidelines* apply), our members must provide energy offers no higher than the relevant Standing Offer; which essentially serves as a price cap (Clause 27 – Pricing Rule).

The proposed VDO will lower the current ‘Standing Offer’ cap, and in some cases this will render some networks as being unviable.

Current embedded network pricing is based on comparing an embedded network offer to several comparable standing offers (e.g. the standing offer for flat (peak only) tariffs and time of use (ToU) tariffs comparable and others.

We would welcome an opportunity to discuss our analysis on the impact of the VDO in relation to current arrangements.

We seek clarity on which customers the VDO applies to (i.e. customers using less than 40MWh versus other customers). The general document mentions in several places that the VDO applies to small business customers who use less than 40MWh, however page 79 notes a ‘customers’ maximum price, without defining ‘customers’.

Embedded networks in Victoria also have to comply with National Energy Laws.

As noted above, a key framework is the AER’s *Electricity Network Service provider – Registration Exemption Guideline*. This framework places pricing obligations on our members, and we seek confirmation that these provisions have been reviewed to ensure our members will be able to comply with the AER’s exempt network obligations and any VDO requirements.

## GEO PRICING RULE / PRICE CAP

We have previously expressed our concerns to the Government about the proposed *Price Cap* approach for embedded networks under the then Draft GEO, but never received any detailed feedback or engagement.

In our submission on the then Final Position Paper for the GEO (September 2017), we provided the following in relation to the proposed price cap.

### PRICE CAP

In relation to *Position 5*, this proposal is a significant concern for our sector.

A key concern is whether the proposed price cap will put embedded network owners in the position of having to operate at a loss. This case is clearly untenable.

We are also keen to ensure there is complete clarity as to how this proposal relates to the Thwaites Report, which is still under consideration by the Victorian Government, particularly in relation to its recommendation on issues such as the ‘Basic Services Offer’, being a ‘no-frills’ energy product for customers.

Critical to the future price cap is what ‘commercial market data’ the ESC will consider in formulating a ‘new cap benchmark’. The Draft Order does not provide a definition of ‘commercial market data’, nor is there a standard or plain English interpretation for this term.

We note that formulation of a ‘new cap benchmark’ will be subject to a separate consultation process with the ESC, and that this reform isn’t proposed to commence until 2019. It is imperative that we are involved in the reform process for formulating the ‘new cap benchmark’.

In the first instance, we submit the following issues for consideration for formulating the ‘new cap benchmark’:

- how will an embedded network owners’ own energy purchasing – which is subject to volatility – be factored into the price cap?
- how will the increased costs of operating embedded networks be considered in the development of the price cap? This includes the cost of ‘Embedded Network Managers’ (ENMs), emphasising that at this stage there are no appointed accredited ENMs, let alone a sufficient market place for the same, which means that the costs associated with ENMs remain unknown.
- how will the costs associated with being an exempt person under the relevant Part, including but not limited to membership fees to an approved external dispute resolution scheme (e.g. annual EWOV levies) and costs associated with any regulatory changes required under the National Energy Retail Law, be factored into the price cap?
- we submit that the price cap should only apply to ‘small commercial / retail customers’, which is akin to the Thwaites Report recommendation that price regulation be applied to those below a 40MW threshold.

In this regard, we recommend that clause 10 (2) is replaced with the following:

(2) The Essential Services Commission must have regard to the following matters in formulating a maximum price:

(a) commercial market data;

(b) the individual characteristics of the customer;

(c) the exempt person’s operating costs which are relevant to them being an exempt person under this Part.

Nothing in this Part limits an exempt person from submitting to the Essential Services Commission other matters it reasonably believes should be considered in formulating a maximum price.

In respect of the interim price cap (under clause 26 (Pricing rule)) we seek clarification that this will be the standing offer in the local district area in which the customer is located. It is important for our members to have clarity on this issue to ensure compliance.

### **AEMC – REGULATORY REVIEW**

Our concerns with the proposed VDO are compounded when other issues are taken into account, which will add substantial costs to operating embedded networks (N.B. this thus relates to the cost-stack model and the need for a specific Pricing Rule to be developed under the GEO).

As a key example, the Australian Energy Market Commission's (AEMC's) current consultation on the proposed new regulatory framework for embedded networks, which seeks to 'elevate' (i.e. add cumbersome, costly red tape) the regulation for embedded network owners and operators, will substantially increase operating costs.

The AEMC's recent consultation material was bereft of any detailed costings, which means that preparing and analysing such costings was outsourced to groups such as ourselves.

Based on our estimates, the AEMC's approach will lead to the following increased costs:

#### *AEMO / AER registration costs*

- We understand the cost to register with AEMO as a DNSP can be around \$20,000. We understand the cost to prepare an application can be around \$60,000 to \$90,000.
- We are also aware of ongoing annual AEMO costs that may be relevant (e.g. under *AEMO's 2018-19 Consolidated Budget and Fees*), which have not been acknowledged (e.g. a levy for Energy Consumers Australia).

#### *Meter replacement*

- For one of our members, the cost to replace pre-2012 meters is estimated to be more than \$2 million. This excludes the likely need to find additional space (e.g. floor area) to house the required infrastructure.

#### *Metering coordinator*

- Similar to the above, the potential increased cost for the metering coordinator function for one of our members is estimated to be around \$200,000.

#### *ENSP Obligations*

- The proposed ENSP obligations (data provision, market interface) noted at page 41 of the Draft Report are cause for significant concern. On the basis that additional staff may be required, we have been advised that this could create additional operating costs of around \$25/meter/annum.

While the AEMC's current work may be separate to consideration of the VDO, embedded networks owners and operators are obliged to consider these issues, which are ultimately substantially adding to costs and complexity to run embedded networks.

In this regard, we believe this highlights the need for a specific approach for embedded networks under the Pricing Rule in the GEO. The above issues become what could be considered to be 'market conditions' under the GEO Pricing Rule.

### **OTHER ISSUES**

In addition to the AEMC's current regulatory review, are other current considerations such as the proposed *Competition and Consumer (Industry Code-Electricity Retail) Regulations 2019*, the AER's current consultation (Draft Determination) on *Default Market Offer Price*, and the ACCC's current consultation in relation to the Consumer Data Right (CDR), which expressly notes potential new requirements for embedded networks.

### **RECOMMENDATIONS**

We respectfully make the following recommendations for the ESC's consideration, which we believe are consistent with the *Terms of Reference*:

- That the ESC engages with the SCCA to better understand shopping centre embedded networks and relevant issues.
- That the VDO does not apply to shopping centre embedded networks from 1 July 2019, and is deferred to January 2020, to enable further investigation and consideration – including withdrawal of ToU issues and network tariff issues. Subject to a decision, we believe this could be achieved via an amendment to the GEO including the reference (at Clause 27) to section 35 of the *Electricity Industry Act 2000* and/or under any new Order made under section 13 relevant (e.g. price determination) to section 35 of the Act (as amended).
- Noting the above, that the ESC immediately commences the development of a *Draft Pricing Rule* under Clause 10 of the GEO in consultation with shopping centre embedded networks owners and operators.

- In developing a *Draft Pricing Rule* for consultation, that the ESC considers the SCCA's previous advice to the Government on the GEO Pricing Rule / Price Cap (see above).
- In developing a *Draft Pricing Rule* for consultation, that the ESC considers other relevant issues such as the AEMC's proposed regulatory framework and the *Competition and Consumer (Industry Code-Electricity Retail) Regulations 2019*.
- That the ESC confirms which customers within embedded networks are intended to be covered by the VDO.
- Subject to the above, that embedded networks are able to charge rates above the VDO as is proposed for energy retailers.
- That the ESC provides clarity in relation to embedded network compliance with the AER's exempt network pricing obligations and any VDO requirements.

We also believe that the above aligns with other aspects of the *Draft Advice*, noting the 'first VDO' applies from 1 July 2019 to 30 December 2019. The interim period could be used to properly consider embedded network issues.

### **CONCLUSION**

We would welcome an opportunity to discuss this submission with the ESC, including options for further investigation and consideration.