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Essential Services Commission
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Melbourne, Vic, 3000
emailed address: retailenergyreview@esc.vic.gov.au

Submission re: Victorian Default Offer to apply from 1 January 2020: Issues Paper 23 July

Dear ESC,

The comments provided in this submission reflect the view of Network Energy Services and the interests of our Exempt Selling clients and their internal customers.

Network Energy Services is an Embedded Network Manager working with around 150 Retirement Villages, Land Lease villages, Caravan Parks and 'Over 55s' resorts structured as embedded networks. In addition to our role as Embedded Network Manager we provide data management, billing, compliance, advisory and customer service for about twenty thousand customers in these embedded networks.

This submission is in response to the ESC request for information and views on embedded networks, how a maximum price may be constructed for embedded networks, and key issues with setting those prices; as set out in the Essential Services Commission issues paper titled 'Victorian Default Offer to apply from 1 January 2020: Issues Paper 23 July'.

On behalf of our clients and their end-user customers, we consider it important that the ESC team is made aware that embedded networks provide significant benefits to consumers in certain instances.

In particular we refer to the hundreds of electricity on-selling 'communities' that are established for the benefit of the residents, particularly retirement villages and over-55 resorts that are embedded networks.

In this submission we refer to **On-Selling Communities**. On-Selling Communities comprise embedded network operators and exempt sellers that provide significant benefits to consumers in a community setting.

Elderly residents living within these On-selling Communities (in which there are tens of thousands of residents) consistently receive competitively priced electricity, customised customer service for aging consumers, and reduced common area electricity costs (which assists with reducing their cost to live in these villages).

These villages are also able to structure electricity tariffs which are better suited to elderly consumers who are more likely to be at home during daytime hours, and as such, consuming electricity during peak period. The consumption profiles of these consumers can vary from ill and housebound consumers using upwards of 7,000 kWh per annum to grey nomads who escape the Victorian winter for several months of the year. The types of tariffs that may suit a consumer's need can vary.

There are a number of factors that may be significant when considering a maximum price:

(i) Ensure the benefits for consumers achieved by On-selling Communities, particularly those that return the benefits to the communities, can be continued and supported.

(ii) Enable On-selling Communities with a single rate electricity tariff (also known as a flat tariff) to select its mix of daily and usage rate such that the consumers within those communities are purchasing at or below an ESC specified parameter, even if those parameters comprise the VDO compliant maximum annual bill (as adjusted to accommodate single rate tariffs in embedded networks).

(iii) Enable On-selling Communities to adopt an appropriate mix of fixed and variable rates that will provide lower usage prices for consumers, some of whom reside in premises where electricity powered appliances are the only choice available for heating, cooling, etc. Note that the majority of our On-selling Community consumers are elderly and high usage tariffs will for some consumers deter electricity usage at times when they should be using electrical appliances to maintain a healthy home environment.

(iv) Continuation of the great work undertaken by the ESC around ensuring energy offers can be easily compared, access to schemes and concessions, dispute resolution, and other ESC and AEMO led initiatives.

(v) Ensuring that the viability of the Exempt Selling activities of these On-selling Communities is not compromised by a consumer price ceiling that is too low, and as such reduces revenue to the extent that these villages struggle to pay their parent meter bills and/or service providers;

(vi) The ability for embedded networks to offer Market Offers to residents;

(vii) The ability for embedded networks to apply to the ESC for special consideration where there is a particular issue prevailing in that embedded network; and

(viii) We note that the current frozen standing offer prices are providing upper level price protection to embedded network customers.

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Overview

The embedded networks that we work with endeavour to provide usage prices that are consistently market leading and these discounts are predominantly applied to the standing offer usage rates, since this was historically the approach used by licensed retailers but more importantly this type of discounting is beneficial for elderly or ill consumers who use (either voluntarily or otherwise) large amounts of energy during daytime hours to maintain comfortable living conditions.

The supply charge generally has either a small discount off the Default Retailer's standing offer supply charge or be equal to the Default Retailer's Standing Offer supply charge.

Moreover, for the vast majority of our clients, their residents already receive electricity cheaper than a 'Low User[1]' VDO customer, with those electricity customers savings increasing as their electricity usage increases.

On the whole, On-selling Community residents pay the costs of operating and maintaining their village via a monthly service fee. Typically, the village embedded network provides the following benefits:

1. consistently competitively priced electricity, usually but not always on a single rate tariff;

2. valued customer service;

3. customised electricity tariffs for retirement living e.g. single rate electricity tariffs may be set in a manner to encourage residents to maintain a healthy home environment through heating, cooling and powering medical devices by offering larger usage discounts;

4. reduced electricity costs for the village common facilities such as community centres and street lighting, which helps to reduce the cost of living within the On-selling Community;

Embedded networks therefore enable On-selling Community residents to benefit in many ways, directly and indirectly. A NEM Retailer has no interest in providing such benefits to residents and their village and preservation of this type of opportunity for retirees and low social-economic groups (such as caravan parks), should be a priority of any reform.

Our clients and their customers recognise that there are some exempt sellers who do not place their interests of their customer as a priority and that a maximum price for embedded networks will, as the VDO has done for retail customers, deliver consumer benefits.

We request that care be taken to not unnecessarily impose additional costs (or revenue controls that prevent On-selling Communities from offering usage discounts in lieu of lower supply rates) for embedded networks to the detriment of those consumers benefiting within these communities.

[1] As per ESC procedures for Low User annual bill for residential customers

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It is possible that thousands of very satisfied embedded network consumers in retirement villages are perhaps invisible to the ESC because those residents are satisfied with their service and feel no need to complain.

On-selling Communities and the VDO

The VDO has been outstanding in so many ways in addressing a fairer deal for electricity consumers.

While our exempt sellers had made appropriate preparations for a VDO commencing on 1 July 2019, it was apparent that On-selling Community residents that had very low usage (i.e. below the VDO Low Usage threshold) would see a reduction in their electricity bills.

It was our expectation however that had the VDO been implemented that the overwhelming majority of residents would have received significantly higher electricity bills (as their electricity discounts were usage related). Also, the indirect benefits that some On-selling Communities were receiving would be reduced.

There is the risk that in reforming embedded network maximum pricing, there may not be adequate recognition, or understanding, of the benefits for consumers from embedded networks and that some of the reforms would be detrimental to consumers.

Of course, there may be embedded networks that do not have the consumer's interests as a major priority and we totally support enabling consumers to access a fair deal in such situations. For the forthcoming ESC embedded network process to support embedded networks that have fairness and benefits for consumers as their primary concern should be encouraged.

Major Differences in various costs

This section seeks to outline the underlying cost structure of embedded networks which has differences to NEM Retailers. These facets mean that the apportionment of fixed costs and variable costs for embedded networks is different, and in the case of On-Selling Communities the objective is focused towards the welfare of that community.

Embedded networks must purchase electricity from NEM Retailers. Many embedded networks are required to purchase electricity in 'un-bundled' contractual arrangements.

Those 'un-bundled' contractual arrangements establish a contracted electricity energy price for peak and off-peak electricity, and potentially some price parameters around environmental contributions, meter fees, etc.

Contractual arrangements are entered into with NEM Retailers, often for a number of years into the future and then packaged and sold to consumers on a 'bundled' basis (with prices adjusted say annually or preferably less often).

There are other parent meter bill expense items that are passed through to the embedded network.

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The challenge for embedded networks is to fit parent meter contractual arrangements and operating costs within any resident price control, which is currently the Standing Offer.

For On-Selling Communities the Standing Offer has worked well by enabling electricity discounts to be structured towards electricity usage rather than supply charges.

The following are noted:

- each embedded network will have typically one parent meter contract arrangements with a NEM Retailer, this maybe for one embedded network site or multiple sites. Those energy contracts generally have the following characteristics:
    - a set start date and end date
    - a specified quantity of electricity to be supplied with ~ 20% flex around that quantity
    - contracted energy rates for the period
    - potentially contracted environmental rates
    - meeting the credit requirements of the NEM Retailer
    - meeting the prevailing contractual requirements of NEM Retailers, which are also evolving in relation to its market conditions

- un-bundled parent meter expenses that are passed through to embedded networks include:
    - network components according to the appropriate tariff
    - loss factors
    - network demand tariffs
    - other charges introduced by the AER, AEMO and other regulators

- the parent meter contract arrangement, in particular the availability of competitive NEM Retailer parent meter offers, and the eventual agreed energy price, is a vitally important factor in any embedded network being able to offer competitive prices to consumers. We note that, on the whole, this market is working effectively, efficiently and fairly.

- Embedded networks will vary substantially in their on-selling performance which vary according to the parent meter buy rates, demand level, capacity demand, peak / off peak usage profile, and physical aspects, such as number of billable customers, number of parent meters etc.

- It is possible that embedded networks may not have the experience, resources or scale to negotiate competitive energy agreements from NEM Retailers, and may need to utilise specialist advisory services … which may also increase cost.

- NEM Retailer parent meter energy agreements typically offer lower energy costs for longer term contracts, and are subject to prevailing market conditions and volatility. Striking a long-term energy contract during a period of high energy price volatility (say for example the unexpected early closure of a generator) will commit consumers in subsequent years to certain price levels. These energy contracts cannot be cancelled without significant expense, even if that high energy price volatility dissipates quickly after closure of the energy tender.

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Similarly selecting short-term electricity contracts, where energy prices are substantially higher than long term energy rates, will commit consumers to higher price levels immediately.

Embedded network operators should not be speculating on energy contracts and should be contracting in good faith for long term customer benefit.

Importantly, an embedded network that selects a long energy contract in an electricity market that is unduly stressed, with a view to offering great value to its customers for the long term, can find itself disadvantaged by a regulatory customer price control that is set when market electricity prices or volatility are lower.

Embedded Networks rarely have the opportunity to have multiple energy contracts or alternative hedging instruments, thereby preventing them from participating in the energy market at different volatility periods.

- In the last three years particularly there been a lot of unexpected change in energy charges, network charges, environmental charges, solar installations, other unbundled costs, regulation, etc. Some of these costs are non-negotiable, cannot be forecast and need to be absorbed by the embedded network.

- On-selling Communities typically take price decisions once annually and usually in conjunction with setting financial budgets with residents and other stake holders. Electricity forecasts can occur six months before resident price implementation, and will typically forecast 12 months or more of performance. This forecasting work needs to make assumptions around all costs and what competitive offers are (and might be) available to residents outside of embedded networks.

- Proposed AEMO changes to embedded networks (discussed herein) will increase embedded network costs and need to be planned for now, as a four-year parent meter contract with a NEM Retailer will carry over into potentially new embedded network regulation.

Mechanism for setting a maximum price for embedded networks

The ESC is preparing a process for formulating a VDO for embedded network customers. Implicit in this is that embedded network providers can offer a price below any maximum electricity price.

The current standing offer prices for Embedded Networks are frozen and by default is providing upper level price protection for consumers which over time will decrease in real terms.

Network Energy Services are advocating for embedded networks to have sufficient flexibility such that an electricity tariff can be offered to customers which enable a daily rate that is higher than the VDO, but an electricity usage rate that is sufficiently below the equivalent VDO rate that an electricity user is no worse off.

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This could be achieved with an Embedded Network maximum annual bill concept similar to what is proposed in the ESC's paper, the ability for embedded networks to make market offers to its customers, or the ability to seek special consideration from the ESC in unique circumstances.

At present the transitional pricing rule within the General Exemption Order governs the electricity tariffs that Exempt Sellers in Victoria can charge; which is the standing offer tariffs of the 'licensee who is the local retailer for electricity supplied in the electricity distribution area in which the supply point for the supply of electricity to the customer is located' as at 30 May 2019.

This type of discounted usage rate is especially beneficial for elderly and ill consumers who use large amounts of energy during daytime hours to maintain comfortable living conditions through colder and hotter times of the year.

It will be a grossly unfair situation if On-selling Communities were required to restructure all of their tariff offerings so that supply charges were decreased substantially (for example to match the current VDO supply charge), and usage rates had to be increased substantially to offset that revenue. This would inevitably mean that many vulnerable consumers will end up paying more for their electricity, and/or changing their electricity consumption to offset the cost increase.

We note that licensed retailers are able to make "market offers available to customers that differ from the VDO," however the same provisions have not been provided to On-selling Communities at this point in time. It is therefore only fair and appropriate that any embedded network price control provide sufficient flexibility for tariffs such that its benefits consumers in that network.

Impediments to accessing competitive offers

A major barrier to right of choice is the current lack of opportunity for consumers wanting to churn to find a NEM Retailer willing to supply them.

NEM Retailers seem unwilling to supply consumers in embedded networks. There may be many reasons behind this, however an important consideration is that consumers are used to comparing bundled offers.

The AEMC recently released its Final Report titled 'Updating the Regulatory Frameworks for Embedded Networks - 20 June 2019'.

Network Energy Services note that this report, depending on how it is adopted and implemented, will provide a structure that can support choice.

How this structure subsequently interacts with an ESC developed embedded network pricing mechanism, or how an AEMO controlled pricing mechanism compares to the VDO for some legacy networks, creates uncertainty for the ongoing management of embedded networks.

The AEMC reforms will add unavoidable cost and a stringent consumer price cap will inhibit a viable transition to these potential reforms.

Conclusion

This submission provides input that may assist in the formation of price controls for embedded networks.

Exempt Sellers should have the capacity to structure their tariffs in a way that meets their consumers differing needs. As consumer movement becomes more practicable for consumers within embedded networks, it is essential that there is not a two-tiered pricing environment between the flexible offerings of licensed retailers verses a limited envelope of offerings by Exempt Sellers, should a stringent maximum price be imposed. It is essential that Exempt Sellers can provide customised offerings so that they can compete against the market offerings of licensed retailers.

On-selling communities can deliver substantial benefits to electricity consumers both directly and indirectly provided they can enter electricity parent meter contracts in an effective, fair and efficient NEM Retailer market (which is the case now), where business risks are understandable, predictable and manageable, and where low operating cost choices can be made for the benefit of all stakeholders.

Appropriate embedded network price controls can achieve consumer results, in lieu or in conjunction with right of choice mechanisms

Network Energy Services has been supporting and providing ethical services within the embedded network sector and specifically in the retirement village space for more than 20 years. We would welcome the opportunity to present additional information to the ESC.

Protecting community minded electricity on-selling will benefit vulnerable consumers both now and into the future.

Yours sincerely

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