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Mr Greg Wilson
Chairperson
Essential Services Commission
Level 2, 35 Spring St
Melbourne VIC 3000

By email: smallscalelicensing@esc.vic.gov.au

Dear Mr Wilson

Re: Small Scale Licensing Framework

I attach a submission from AGL Electricity Limited (AGLE) in response to the *Small Scale Licensing Framework* issues paper released by the Commission in July. The submission covers AGLE's interests as a licensed electricity distributor.

Should you wish to discuss the submission, please contact Rohan Jones (03 9201 7063).

Your sincerely

A handwritten signature in blue ink, appearing to read 'Robert Wiles', is written over a light blue circular stamp.

Dr Robert Wiles
General Manager Regulation and Policy



Small Scale Licensing Framework

Executive Summary

This submission by AGL Electricity Limited (AGLE) is made in response to the *Small Scale Licensing Framework* issues paper (the Issues Paper) released by the Essential Services Commission in July. The submission covers AGLE's interests as a licensed electricity distributor.

AGLE supports a framework that encourages competition in the market and provides customers with protection with respect to quality and reliability of supply; allows them to choose the retailer that offers the price and service mix that best meets their needs; and provides access to a dispute resolution mechanism.

Under current arrangements in Victoria that allow for exemption of certain network and reselling operations from licensing requirements, the exemption criteria lack clarity and could well facilitate an expansion or "creep" in the scope and scale, as well as in the number of operations classed as exempt. There is anecdotal evidence that this is occurring. The result is that increasing numbers of customers are exposed to lesser (or uncertain) standards of service, protection and competitive choice than are provided to customers connected to a licensed distributor's network. This is undesirable.

It is reasonable to assume that those who establish embedded networks are motivated by the opportunity to purchase energy and/or distribution services at rates associated with a Parent connection point and on-sell it to customers at higher "Pricing Rule" rates. This is a form of "cherry picking" and is made possible by the fact that distribution tariffs are, of necessity, set on an average basis. One possible response would be to establish differential network tariffs, but that is unlikely to be acceptable. However, if embedded networks are permitted to proliferate, the result will be essentially the same.

AGLE favours refinement of Victorian arrangements so that all embedded network operations are licensed unless exempt (appropriately defined). Exemption criteria will be critical. The test for exemption should be based on an assessment of the costs of configuring the network to provide customers with choice of retailer and customer protections normally associated with electricity supply, and the benefits to customers of having that choice and those protections. Only where the costs exceed the benefits should the network be exempt. As a matter of principle, a network that is constructed or reconstructed with the primary purpose of enabling the (re)sale of energy and/or distribution services should not be eligible for exemption. Where appropriate, specific classes of operation such as caravan parks should be defined as exempt.

All Australian Governments have agreed that licensing responsibilities will be transferred to the Australian Energy Regulator to establish uniform national arrangements. Licensing arrangements for embedded network operations in Victoria that are not exempt should be framed with this in mind.

While AGLE has concerns with the current exemption criteria in the Order in Council (OIC), conditions that currently apply to exempt operations, are generally adequate for such operations. However, if and when retail pricing is deregulated, there will be a case for re-visiting the Pricing Rule.

AGLE's comments on the Issues Paper follow.



Specific comments on the Issues Paper

1. Stakeholders are invited to comment on:
 - the extent to which small scale distribution and/or reselling of gas or electricity is occurring within the Victorian market
 - the reasons why small scale distribution and/or retailing are becoming increasingly prevalent in the Victorian market.

AGLE has no knowledge of the extent to which small scale distribution and/or retailing is occurring in gas. In the case of electricity, AGLE is not able to identify embedded networks as such in its systems, and does not collect statistics that would enable a trend to be quantified for its network. However, there is anecdotal evidence that the number of embedded networks is increasing.

AGLE has no knowledge of the reasons why the incidence of small scale distribution and/or retailing may be increasing. However, it is reasonable to assume that those who engage in such activities see some commercial advantage in purchasing energy and/or distribution services at rates associated with a Parent connection point and on-selling it to customers at higher "Pricing Rule" rates. The barriers to setting up an exempt operation are also minimal:

- exemption under the OIC can be on a self-assessment basis; and
- the obligations attaching to an exempt operation are not onerous and are not visibly enforced.

It may be informative for the Commission to enquire of certification applicants why they chose to engage in small scale distribution and/or retailing in the first place, and also why they sought certification rather than relying on self-assessment. For example, the increase in certificates could be driven by the applicants' governance issues – the desire for certainty.

The Commission suggests at page 13 of the Issues Paper that customers may benefit from lower tariffs by forming embedded networks and that licensed distributors' tariffs to end-use customers may be higher than they should be to reflect the cost of supply.

Distribution tariffs are necessarily struck on an average basis with the unavoidable result that some customers pay more than their true cost of service and others less. The opportunity for embedded networks to "cherry-pick" customers would be removed if tariffs were fully cost-reflective, but the resultant price differentials would be politically undesirable. For example, a business in a shopping strip could be paying more for electricity than an otherwise identical business located in a nearby shopping mall. But, that is essentially what will occur if embedded networks are permitted to proliferate. As the Commission observes, the host distributor's costs do not change greatly with the formation of an embedded network so, while customers on an embedded network may enjoy lower charges because of their peculiar position, the reduction in distribution revenue will ultimately be made up from customers outside the embedded network through higher tariffs.

Embedded network operators also have lower operating costs because they offer fewer services and have fewer obligations imposed on them. A "full service" distributor must provide twenty-four hour fault and emergency telephone and response services; must meet customer protection obligations imposed through participation in the ombudsman scheme; and must meet minimum performance standards or make guaranteed service standard payments. Electricity distribution businesses are also subject to a range of regulatory obligations and associated reporting and audit requirements, all geared to ensuring the provision of reliable, safe and fair electricity services to customers.



The Commission should be wary of operators of embedded networks who wish to have the benefits associated with the ownership of an electricity distribution network without the responsibilities.

2. Stakeholders are invited to comment on the definitions in the OIC, whether they may be facilitating the increasing number of small scale activities being undertaken and whether there are any implications of this.

The increase (from a very low base) in the number of certificates issued is not necessarily an indication that there has been a corresponding increase in the number of exempt operations: the Commission itself acknowledges that it does not have quantitative information. Having said that, there is anecdotal evidence that the number of embedded networks is increasing and it is apparent that the lack of definition of terms such as "owner", "occupier", and "incidental" in the current OIC could well facilitate an expansion or "creep" in the scope and scale, as well as in the number of operations classed as exempt. The result is that increasing numbers of customers are exposed to lesser (or uncertain) standards of service, protection and competitive choice than are provided to customers connected to a licensed distributor's network. This is undesirable.

AGLE favours a structure wherein all embedded networks are licensed unless exempt. This would require the establishment of:

- a definition for "embedded network" or "small scale operation";
- exemption criteria;
- appropriate licensing obligations for those small scale operations that are not exempt; and
- a schedule of any specific classes of operation that are to be exempt, notwithstanding the exemption criteria. For example, it is generally accepted that caravan parks, tenanted rooming houses, and office buildings where energy costs are embedded in rents, should be exempt. It may not be possible to frame generally applicable exemption criteria that ensure such operations are exempt in all circumstances.

A public register of exempt embedded networks should be maintained.

3. Stakeholders are invited to comment on:

- whether the Victorian arrangements should be aligned with the national framework
- whether there is value in extending the current range of exemptions at the national level to apply to resale activities and/or distribution and resale activities
- whether the change should be realised by changing the OIC or the industry Acts.

The Commission refers (Table 3.1) to the categories that qualify for exemption from registration as a network service provider under the National Electricity Rules (NER). The purpose and effect of requiring registration of network service providers under the NER are not the same as the purpose and effect of requiring licensing under relevant industry legislation in Victoria. Consequently there is no inherent reason why the criteria for exemption under the two regimes should be the same.

In AGLE's view the arrangements surrounding embedded networks, including exemption criteria, should be refined now and as necessary to meet Victorian requirements. At the same time it should be noted that the Australian Energy Market Agreement 2004 as amended in 2006, confirms that distribution and retail regulatory functions, including



distributor and retailer general business authorisations for matters other than technical capability and safety, will be transferred to the AEMC and AER. Enabling legislation is to be passed by 1 January 2007, with implementation expected by 1 January 2008. The licensing arrangements to apply to embedded networks/small scale operations that are not exempt should therefore be framed with this in mind.

As to the means of implementing change, amendments to Regulations under Industry Acts could be considered as an alternative to amending the OIC or Industry Acts themselves. (Regulations provide an intermediate level of flexibility.)

4. Stakeholders are invited to comment on:

- whether exemptions should be restricted to incidental supply and how incidental supply should be defined to distinguish it from the activities undertaken by small scale operators.
- the advantages and/or disadvantages of licensing small scale activities.
- whether any revised arrangements should apply to parties that are already exempt and, if so, by what process should they be brought within the revised framework

In the structure favoured by AGLE (see point 2 above) it would be necessary to define an embedded network. There is an existing definition in the Electricity Customer Metering Code (ECMC), viz:

“embedded network” means a distribution system to which customers are connected that is not owned, operated or controlled by a distributor licensed by the Commission and in which the energy supplied to children has been recorded by a meter used to record the consumption of the parent.

For the purposes of identifying a small scale embedded operation this could be amended as follows:

“embedded network” means a distribution system to which customers are connected:

- in which the energy supplied to customers (whether or not by way of children) has been recorded by a meter used to record the consumption of the parent;
- that is owned, operated or controlled by a person that is not the distributor that owns, operates and controls the distribution system that supplies energy to the parent; and
- that is situated within contiguous land all of which is owned by the same entity or entities.

An embedded network (licensed or exempt) should be prohibited from supplying another embedded network.

Where a network is situated on land owned by different entities, it would not be classifiable as a small scale embedded network – it could be classified instead as an inset network.

An embedded network should be licensed as such unless it is exempt. The Commission proposes that the basis for exemption should be that the distribution or supply service is “incidental” to the principal service provided by the network operator. The factors proposed by the Commission at page 20 of the Issues Paper are appropriate. However, there are some difficulties associated with defining “incidental” including:

- If the definition is based on the duration of the arrangement between the operator and the customer, operators might avoid long term relationships in order to maintain



an exemption. Alternatively, one long term relationship among many short term relationships could, technically, trigger a loss of exemption.

- Basing the definition on some measure of materiality e.g. energy costs are small in relation to the cost of the principal service, would involve forecasting and could also distort behaviour.

An alternative approach, and AGLE's preference, is to base exemption on an assessment of the costs of configuring a network to provide customers with choice of retailer and customer protections normally associated with electricity supply on the one hand, and the benefits to customers of having that choice and those protections on the other. A network would be exempt only if the costs exceed the benefits. As a matter of principle, a network that is constructed or reconstructed with the primary purpose of enabling the (re)sale of energy and/or distribution services acquired at the parent meter, should not be exempt. This would be the case irrespective of whether or not the sale of energy is an incidental part of the total relationship between the network owner and the customer.

The manner in which the costs and benefits test will be applied (including possible rules of thumb or methods for quantifying costs and benefits) could be addressed in published guidelines developed through consultation. To remove doubt, those categories such as caravan parks, tenanted rooming houses, and the accommodation sections of hotels that will be exempt under all circumstances, should be defined specifically.

The purpose of licensing small scale operations of an appropriate scale is to ensure that they are subjected to the enforcement arrangements associated with licensing and that customers have the benefit of levels of customer protection and access to competitive supply that are enjoyed by customers in the wider market. A further advantage is that each connection point (NMI and Standing Data) within an embedded network will be identified (see point 10 below). The identification of all connection points will support the Commission's End-to-End objective of facilitating the development of systems and processes that support customers moving efficiently from one retailer to another, at relatively low cost, and receiving accurate billing information within acceptable timeframes.

The only apparent disadvantage of licensing small scale activities would be the administrative cost of licensing, and of any accompanying compliance monitoring and enforcement arrangements.

Any revised arrangements should be applied to existing exempt operations via a staged implementation process. In this context, there should also be provision to allow an exemption to continue where the costs associated with withdrawing the exemption would exceed the benefits. All exempt operations under the new arrangements should be registered. Any operations that do not qualify for exemption would then (subject to meeting relevant criteria) be licensed as a small scale operation and allowed a period of time (say 12 months) to demonstrate compliance with administrative requirements. A longer period could be allowed for the businesses to achieve compliance with technical requirements.

5. Stakeholders are invited to comment on the value of extending the exemptions framework to the small scale distribution and/or resale of gas.

In AGLE's view it would be inappropriate to extend the current exemption framework to gas. Extension to gas could be considered once refined arrangements have been developed and proven for electricity. Arrangements for the two fuels should be aligned as far as possible at that stage.



6. Stakeholders are invited to comment on whether the current terms, conditions and limitations contained within the OIC are sufficient for the regulation of small scale electricity distribution and/or retailing.

In AGLE's view the current terms, conditions and limitations contained within the OIC are generally adequate for an exempt operation (appropriately defined) but not for a licensed small scale distribution operation. There are two aspects of the current conditions that require comment:

- If and when retail pricing is deregulated, it will be necessary to re-visit the Pricing Rule.
- EWOV is the preferred body to deal with disputes. However, current funding arrangements present a barrier for small operators. This would be removed if EWOV were paid on a fee for service basis (see point 7 below).

7. Stakeholders are invited to comment on:

- the value of the current customer review and dispute resolution mechanisms provided under the OIC
- the extent to which small scale operators are currently compliant with the OIC's dispute resolution mechanisms
- whether customers in small scale arrangements should have access to EWOV's dispute resolution scheme, how this could be facilitated and the advantages and disadvantages of providing access, including the likely impact on small scale operators
- what alternative customer dispute mechanisms could be provided for and the advantages and disadvantages of these alternatives.

AGLE is not in a position to comment on the extent to which small scale operators are currently compliant.

As the Commission observes, the VCAT system is not free to the customer and often involves a lengthy process. The result can be less satisfactory from the customer's point of view than it would be under the EWOV system. On the other hand there are costs to distributors and retailers joining the EWOV scheme.

In AGLE's view, EWOV is better placed to deal with complaints relating to the energy industry than the VCAT. AGLE's preference would be for EWOV to adopt a funding system similar to that in South Australia where operators pay on a fee for service basis rather than paying joining fees and annual fees. This would enable small operators to utilise EWOV's services.

On balance, and given the current funding arrangements for EWOV, it is appropriate for exempt networks (appropriately defined) to continue to utilise VCAT. This could be reviewed if the EWOV funding arrangements were changed to fee for service. Licensed small scale operations should be required to join the EWOV scheme.

Whatever the arrangement, it is important that embedded network operators be required to advise their customers of the availability of a dispute resolution process.



8. Stakeholders are invited to comment on:
- the extent to which small scale operators provide more (sic) might provide excluded or ancillary services and/or meter provision and meter reading services
 - the extent to which the Pricing Rule or the OIC in general, if properly enforced, is sufficient to protect customers in regard to the prices that small scale operators charge for any 'excluded' services and meter provision and meter reading services that they may provide.

Small scale operators (exempt or licensed) should only be permitted to supply excluded or ancillary services to customers if they comply with all of the safety and technical rules under which other licensed distributors must operate. Prices for services provided by licensed small scale operators could be established through the licensing process. In the case of exempt operators, the rules under the OIC may be adequate. In any event, exempt operators (appropriately defined) are unlikely to provide such services on any great scale.

9. Stakeholders are invited to comment on:
- extent to which customers within an embedded network can and do access alternative retailers
 - what barriers to competitive retail access may exist for customers within an embedded network
 - how these barriers may be addressed.

AGLE is not aware of the extent to which customers within embedded networks can and do access alternative retailers. Customers who might wish to purchase electricity from a particular retailer would include branches of large retail chains with national contracts. These customers are often supplied by embedded networks within shopping centres.

There are barriers to customers on embedded networks exercising choice. In the first instance customers may not be aware of their right to choose. There are then practical and financial barriers. Customers are generally required to pay for the installation of a new meter. Arrangements within the network may not allow some characteristics of the customer's load such as maximum demand to be identified separately from overall embedded network quantities, and the customer's metering installation (if there is one) may not have a NMI or otherwise meet required standards. The current solution is to construct separate circuits for such customers. It is possible that metering developments could deal with this concern in future.



10. Stakeholders are invited to comment on:

- whether the terms, conditions and limitations set out in the current OIC remain relevant to situations that could be characterised as incidental supply (as discussed in chapter 3)
- whether there are other prevailing regulatory instruments that may be sufficient to regulate incidental supply arrangements
- which of the current licence terms and conditions should apply to small scale activities if these activities are licensed in the future and why

As noted at point 6 above, AGL considers that conditions currently contained in the OIC are generally adequate for exempt operations, appropriately defined. The following licence obligations should be applied to small scale distribution operations that are not exempt to support efficient operation of the competitive energy market and to ensure customers receive appropriate levels of service.

- Electrical safety within embedded networks should be addressed by requiring compliance with the Electricity Safety (Installations) Regulations 1999 which call up the Australian Standard Wiring Rules. Safety of connection of embedded networks is also addressed by the Services and Installations Rules (SIRs)¹. The requirements of Electricity Safety (Installations) Regulations 1999 and SIRs should be enforced.
- Establishment of systems and processes to collect and maintain NMI Standing Data required to be available pre-transfer.
- Establishment of systems and processes to support NMI Discovery pre-transfer.
- Establishment of systems and processes to maintain data required to facilitate transfer.
- Establishment of NMI, Standing Data and NMI Discovery interfaces.
- Registration of participants and schemes.
- Definition of the scope of each scheme.
- A set of technical, safety and customer service obligations.
- Reporting, monitoring and enforcement.
- Provision of a 24-hour service for receiving fault reports and for dealing with move-in and move-out applications, quality of supply issues, and meter reading problems etc. (As things stands customers will often contact the host distributor rather than the embedded distributor about such matters, adding to the host distributor's costs.)
- A requirement that unbundled electricity charges be disclosed transparently to customers to enable them to make informed decisions about competitive offerings.

It is important that NMIs² be established for connection points on licensed embedded networks so that the existence of costumers served by those networks can be known to the market. It is also important that metering complies with ECMC and NER standards. However, in the case of an embedded network, the present regulatory structures require both the embedded network's Local Retailer as well as the Local Network Service Providers (LNSPs) to be involved in the provision, establishment and management of NMIs. Since LNSPs already have relevant capabilities and access to systems to undertake all of these functions for NEM NMIs, they are in the best position to take on

¹ The SIRs are among the distributor's "reasonable technical requirements" with which the embedded network must comply as a customer under the Electricity Distribution Code.

² In fact the NMI for a connection point on an embedded network should be classed as a "NMI equivalent" for so long as a customer is a customer of the embedded network. It will become a NEM NMI only in the event that the customer elects to move to a mainstream retailer. However, the NMI equivalent should be established from the outset as if it is a NEM NMI to facilitate transfer. It will be necessary to expand the capabilities of MSATS to hold standing data for connection points on embedded networks.



the role of managing those activities for connection points within embedded networks. This will also ensure that embedded network connection point information is established consistently with NEM requirements. LNSPs must be able to recover the costs of providing those services to the embedded network.

The electricity network is interconnected. Existing distributors have significant interaction with other distributors and participants. Increasing the number of embedded networks will increase the complexity of interactions and increase costs for existing distributors.

11. Stakeholders are invited to comment on the effectiveness of the current enforcement arrangements applying to the OIC.

The effectiveness of current arrangements is unknown. It is unlikely that they are fully effective because there is no active process of monitoring and enforcing applicable conditions, and no obligation on the retailer/supplier to notify customers of their right to retailer choice.

12. Stakeholders are invited to comment on what enforcement arrangements should apply to situations of incidental supply.

The enforcement agency should be given the necessary powers to review an exempt operation's compliance with relevant conditions either acting on its own initiative or on information received, and order remedial action where there is non-compliance. The ultimate sanction should be revocation of an exemption which would trigger a requirement to become licensed.

13. Stakeholders are invited to comment on:

- the advantages and disadvantages of introducing a registration system for small scale operators
- how such a system could be established
- who is the most appropriate enforcement agency
- the extent to which the proposed agency has the power to introduce and monitor a registration system for small scale operators.

AGL supports light-handed regulation and favours registration over licensing for exempt embedded networks. The advantages of registration (in combination with licensing for those that are not exempt) is that industry stakeholders will then have access to relevant information about all industry participants; and it will assist the enforcement agency in administering/overseeing compliance with the obligations that apply to exempt operations. The disadvantages are costs of administration.

AGLE believes the Commission is the most appropriate enforcement agency as it has the relevant knowledge and expertise to establish and maintain the necessary systems.



14. Stakeholders are invited to comment on what terms and conditions should govern the activities of small scale distributors and retailers and how should this be regulated? ie imposed by the OIC or license?

The range of obligations that should apply to licensed small scale distributors is outlined at point 10 above.

Licensed small scale distributors and retailers should be subject to scrutiny in the same way as other industry participants. Failure to enforce requirements for small scale operations poses a risk of unfair advantage for those operations when compared with standard businesses (which have substantial compliance requirements and costs), and could result in lower standards being experienced by customers of embedded networks.

Exempt operations should be subject to registration and conditions in Regulations as suggested in point 3 above.

AGL Electricity Limited
August 2006