

# Submission to IPART Draft Report on the Future of Embedded Networks in NSW

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Public Interest Advocacy Centre  
**ABN** 77 002 773 524  
[www.piac.asn.au](http://www.piac.asn.au)

Gadigal Country  
Level 5, 175 Liverpool St  
Sydney NSW 2000  
**Phone** +61 2 8898 6500  
**Fax** +61 2 8898 6555

## About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is leading social justice law and policy centre. Established in 1982, we are an independent, non-profit organisation that works with people and communities who are marginalised and facing disadvantage.

PIAC builds a fairer, stronger society by helping to change laws, policies and practices that cause injustice and inequality. Our work combines:

- legal advice and representation, specialising in test cases and strategic casework;
- research, analysis and policy development; and
- advocacy for systems change and public interest outcomes.

## Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program works for better regulatory and policy outcomes so people's needs are met by clean, resilient and efficient energy and water systems. We ensure consumer protections and assistance limit disadvantage, and people can make meaningful choices in effective markets without experiencing detriment if they cannot participate. PIAC receives input from a community-based reference group whose members include:

- Affiliated Residential Park Residents Association NSW;
- Anglicare;
- Combined Pensioners and Superannuants Association of NSW;
- Energy and Water Ombudsman NSW;
- Ethnic Communities Council NSW;
- Financial Counsellors Association of NSW;
- NSW Council of Social Service;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW;
- Salvation Army;
- Tenants Union NSW; and
- The Sydney Alliance.

## Contact

Alana West  
Public Interest Advocacy Centre  
Level 5, 175 Liverpool St  
Sydney NSW 2000

+61 2 8898 6519  
awest@piac.asn.au

Website: [www.piac.asn.au](http://www.piac.asn.au)



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@PIACnews

The Public Interest Advocacy Centre office is located on the land of the Gadigal of the Eora Nation.

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## **1. Introduction**

The Public Interest and Advocacy Centre (PIAC) welcomes the opportunity to respond to the Independent Pricing and Regulatory Tribunal's (IPART) review into the future of embedded networks (the Review) Draft Report (the Draft). Addressing the significant, long-running impacts and inequities experienced by residents of embedded networks is a critical step in ensuring fairer treatment of NSW households and their equitable, protected access to the energy they need.

We welcome the intent to place consumer protection and outcomes at the centre of consideration for these reforms. PIAC broadly supports the direction in the Draft. All NSW households should have equitable access to safe, reliable, and affordable energy, and protections for that access no matter where they reside, or the tenure of their residence.

IPART's role in this review is crucial in overcoming the fundamental issues with embedded networks, which have been increasingly apparent since they were allowed. The poorer outcomes and protections, and lack of scope for alternatives for consumers, has been well detailed over many years. IPART's Review is an opportunity to start resolving these issues and future-proof regulation of embedded networks to ensure that residents can expect equivalent outcomes to on-market energy consumers. This review is also a critical first step in determining what role properly regulated embedded networks could play in delivering actual benefits for residents.

Embedded networks, properly structured, can provide benefits to consumers through more efficient access to on-site generation, and shared, efficient infrastructure and appliances. However, most embedded networks have been structured to absorb energy cost differentials and take advantage of lighter regulation and less responsibility, to deliver additional revenue for developers and operators.

We note that the Review sits within a context of other reforms including the NSW Government's Action Plan on Embedded Networks and the AER's review of their exemptions framework for embedded networks. In this context we strongly support IPART's crucial role and recommend IPART take the broadest possible view of its remit to recommend reforms to the NSW Government which do not overly rely on potential future action through National frameworks.

## **2. Pricing objectives**

PIAC support the framing of IPART's pricing objectives prioritising consumer outcomes, including that pricing:

- not simply be responsive to costs of supplying customers;
- should not incentivise consumers to use energy efficiently;
- be transparent;
- be easy to monitor;
- that there be pricing stability for consumers.

PIAC broadly supports the draft price setting objectives (draft decision 1), with specific comments on each objective outlined below.

IPART draft price setting objectives	PIAC Response
1. Ensure embedded network customers are not paying more than non-embedded network customers	<p>This objective should be more ambitiously framed to ensure actual equivalence of outcomes for comparative services, recognising that a fair embedded network price should contribute to offsetting other disadvantages currently experienced by embedded network residents.</p> <p>Recommended change:</p> <p><i>Ensure embedded network customers overall bills reflect the consumer detriment resulting from embedded networks residence. Embedded network customers bills should be equal to or less than an equivalent on-market customer.</i></p>
2. <del>Ensure there is no interruption to supply</del>	<p>PIAC recommends reinstating an amended version of this objective.</p> <p>Recommended change:</p> <p><i>Interruptions to supply are limited to maintenance and improvements in the long-term interest of the residents with respect to available price of services and products; quality and reliability of supply; accuracy of usage information; access to supports; and protections benefits for residents. Any interruptions are undertaken with appropriate prior notice and consideration of the needs of vulnerable customers.</i></p>
3. Ensure an embedded network seller is able to recover its efficient costs of supply	<p>PIAC does not support this criterion and does not consider it practical or appropriate.</p> <p>See pg. 8 of our response to the earlier consultation paper for further information.</p> <p>Recommended change: Remove this criterion. If retained in any form, it should be further restricted such that a seller is '<i>ONLY able to recover efficient costs of the supply of energy</i>'</p>
4. Ensure the regulatory costs are proportionate to the problem	<p>Compliance with regulations to ensure strong consumer outcomes is simply a cost of doing business when providing an essential service.</p>

	<p>In this case it is also considering regulatory cost to restore equality of outcomes (not create a new protection). PIAC recommends an amended version of this objective:</p> <p>Recommended change:</p> <p><i>Ensure the regulatory costs are proportionate to the problem, without compromising equity of consumer outcomes and protections.</i></p>
5. Respond to changes in the efficient costs of supplying customers.	<p>This objective should have additional clarity added to ensure it references the costs to supply consumers across the wider market, not only in embedded networks. This is crucial to ensuring equity.</p> <p>Recommended change</p> <p><i>Respond to changes in the efficient costs of supplying customers in the wider energy market.</i></p>
6. Incentivise embedded network sellers to supply energy efficiently and enable the efficient use of energy	<p>PIAC supports this amended objective.</p>
7. Be transparent simple for customers to understand and easy to apply	<p>PIAC supports this objective with amendments such that:</p> <p><i>Be transparent and simple for customers to understand, and easy to apply</i></p>
8. Provide price stability for customers	<p>PIAC supports this additional objective with a minor amendment:</p> <p><i>Provide reasonable price stability for customers.</i></p>
9. Allow for cost-reflective pricing	<p>PIAC broadly agrees with this criterion but notes that this should clearly focus on cost reflective network pricing. Consumers should not be exposed to more cost reflective 'retail' prices unless they have chosen to do so.</p> <p>Recommended change:</p> <p><i>Allow for cost reflective network pricing, while protecting residents' choice of retail pricing structure.</i></p>

10. Be enforceable and capable of being monitored	PIAC supports this amended objective
11. Encourage sustainable energy solutions and accommodate innovation and investment in the energy sector	<p>PIAC broadly supports the first half of this additional objective but notes that ‘sustainable’ can be interpreted differently and as such encouraging zero-carbon energy solutions is clearer in intent. We are concerned that including ‘innovation and investment in the energy sector’ has the potential to cloud the consumer benefit and enable inflated pricing which does not benefit consumers. Such a concept is better placed in the AER’s Network Guideline rather than in IPART’s pricing.</p> <p>Recommended change:</p> <p><i>Encourage zero-carbon energy solutions that benefit residents and customers.</i></p>

### **Recommendation 1**

That IPART consider PIAC’s recommended changes to the draft pricing objectives in deriving an appropriate pricing protection methodology.

## **3. Pricing approach**

PIAC strongly supports the Draft finding that the DMO is not an appropriate maximum price for embedded networks. The DMO is not designed to be an actual protection for consumers. It is not intended as a fair or efficient price and is explicitly designed to encourage ‘shopping around’ for a fair deal. This is not relevant to most embedded network residents and is not an appropriate or effective pricing protection for people living in embedded networks.

The maximum price should be benchmarked, and this benchmarking should be to some of the lowest tariffs available.

PIAC strongly supports the Australian Energy Market Commission’s (AEMC) conclusion ‘that consumer protections should be driven by the needs of customers and not the business model of suppliers’.<sup>1</sup> Consumers’ equal and consistent access to affordable, dependable, sustainable energy must be the fundamental consideration for IPART when assessing different pricing methodologies.

<sup>1</sup> Australian Energy Market Commission (AEMC), *Updating the Regulatory Frameworks for Embedded Networks, Final Report, 2019, i.*



Further to this, PIAC is strongly opposed to the recovery of development capital costs through electricity prices. Capital costs of development are indistinguishable from the development costs of the building itself and are recovered through the cost of the residence, and potentially through ongoing levies. These should be kept clearly separate and have no direct relationship to residents' electricity bills.

We categorically reject the rationale that lowering capital costs through establishing centralised embedded network systems lowers housing prices. The housing market is not predicated on the building cost for the dwelling, but on supply and demand and market trends. Establishing any consistent causative link is impossible given the number of variables which impact dwelling costs. We consider this argument to be based upon the assumption that the possibility of lower cost automatically flows through to end consumer benefit. An assertion which has been consistently disproved in the housing market. In any case this consideration sits well outside IPARTs remit on the cost of energy services. IPART should reject any argument put forward that regulating embedded network pricing will result in increases in housing prices.

The final decision on pricing must ensure that embedded networks have demonstrable consumer benefits, reflecting the lack of choice, limited transparency and fewer protections.

#### **4. Price methodology for electricity and gas**

PIAC supports Draft Recommendation 1 that pricing for gas and electricity embedded networks be set equal to the median lowest offer from active retailers, with prices adjusted every 6 months. The methodology provides crucial scope to account for the additional detriments experienced by embedded network residents and 'discount' the benchmark accordingly.

Implementing this price methodology will:

- Ensure that NSW residents of embedded networks are paying a fair price for their essential energy needs, with this price reflecting (and helping to offset) the disadvantages and detriments resulting from residing in an embedded network.
- Provide a strong incentive for existing and prospective embedded network operators to only consider operating an embedded network where they can deliver demonstrable price benefits to consumers, or where the structure of an embedded network is key to delivering demonstrated benefits. It should effectively act as a strong deterrent to the creation of new embedded networks intended simply to increase operator or developer returns, while leaving open the scope for embedded networks which can deliver demonstrated benefits to consumers.
- Reflect that embedded network operators have chosen the arrangement which provides a financial (and regulatory) benefit for them. They have capacity (and should be required) to pass that benefit to consumers and can unwind the arrangement where it no longer serves their business model.
- Reflect that accessing an on-market retailer is either difficult or impossible for most embedded network residents.

- Reflect that being in an embedded network comes with a range of actual consumer detriments regarding reduced protections and access to supports.
- Recognise that energy is an essential service and provision of that service outside standard supply arrangements should not facilitate additional revenue for the operator at the expense of the rights of the residents.

PIAC continues to hold concerns about time-of-use tariffs in embedded networks. All consumers (regardless of whether they are on-market or in an embedded network) should not be exposed to more cost reflective 'retail' prices unless they have chosen to do so. This is a fundamental aspect of our retail energy market and its basis on consumer choice. Any implementation of more cost-reflective retail tariffs for embedded network consumers must come with appropriate notice, education to improve understanding, and targeted supports and assistance to ensure they are not negatively impacted.

In residential land lease communities where the embedded network seller is also the operator of the community we do not see time-of-use tariffs, demand tariffs, or any other innovative tariff design and do not consider it likely to be appropriate for these circumstances. The meters that measure a resident's usage in these circumstances are rarely sufficiently advanced, and the quality supply often insufficiently consistent to warrant such pricing.

PIAC supports a framework which ensures discounts for low amperage in land lease communities to ensure residents only pay for the services they receive, while providing added incentive to operators to progressively upgrade the quality of supply.

## **5. Pricing methodologies for hot and chilled water**

While PIAC does not support embedded networks in their current form, appropriately regulated embedded networks have potential to help enable good consumer outcomes. For instance, where space limitations or building density mean that it is more practical and efficient to provide centralised services, i.e. there is not enough space for individual water heaters and/or air conditioning compressors.

Experience to date demonstrates that these efficient outcomes which benefit residents will not occur without robust regulation. With no requirement on developers to demonstrate tangible beneficial consumer outcomes through efficiency, the choice of common water heater or chiller has been, in most circumstances, to reduce costs or burdens on the developer to the ongoing detriment of the residents.

### **5.1 Hot water**

PIAC supports a pricing methodology that incentivises the efficient electrification of hot water systems. A review will be required to ensure that the draft hot water pricing methodology is actually encouraging efficient electrification and that the resulting savings are being passed on to consumers. PIAC would appreciate clarification that heat pump hot water embedded networks

will not be disadvantaged by benchmarking hot water prices to gas, and whether the common factor safeguards against this.

PIAC supports hot water being billed in energy units, which will better allow access to protections afforded to energy consumers. Where customers are billed in cents/Litre, sufficient explanatory information must be included on bills to allow consumers to understand and compare energy prices.

### ***Recommendation 2***

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*An explanation of how pricing is calculated should be included on consumer bills.*

## **5.2 Chilled water**

PIAC broadly supports the draft pricing methodology for chilled water, including 'chilled water embedded networks' being inclusive of all centralised air-conditioning systems. We support increased transparency over the efficiency of air-conditioning systems. However we note that the methodology does not account for the inability of tenants to 'opt-out' of the network and install their own infrastructure.

## **6. Compliance and enforcement framework**

PIAC congratulates IPART for proceeding to ensure compliance and monitoring improvements for NSW. It is not appropriate to wait and rely on any potential national action that has been continually delayed or avoided. However, a complaints-based system with no licensing or registration framework is not a sufficiently robust or appropriate option.

A crucial first step in achieving effective compliance and enforcement is for the NSW Government to collect fundamental data on embedded networks including:

- how many embedded networks there are,
- what business structures are in operation,
- what services are provided, and
- how many people live within these arrangements.

These data points are critical to overcoming the ongoing inertia that has prevented reform. Namely that the cost/benefit of reform cannot be established because the embedded network framework has no scope to meaningfully determine how many people are impacted, let alone what those impacts are. This is an unacceptable situation that IPART must seek to resolve.

The perceived inability of exempt sellers to comply with requirements is not an appropriate consideration. Complying with regulations is simply a cost of doing business when supplying an essential service. Other services with significant safety implications for consumers (restaurants, medical and retirement facilities, childcare facilities and schools) have basic registration requirements that enable some level of oversight. There is no reason a similar level of data collection cannot be applied to embedded networks. If embedded network operators are incapable of adhering to regulations that protect consumers, they are welcome to unwind the arrangement where it no longer serves their business model.

While PIAC would prefer a more proactive compliance and enforcement framework, we recognise and support that IPART has sought to strengthen the complaints-based system through empowering the regulator to investigate potential non-compliance. It is important that all people in embedded networks have access to compliance and enforcement mechanisms. More consideration needs to be given in particular to disadvantaged consumers including tenants and residential park residents who have an asymmetrical power relationship with their landlord and/or embedded network operator. These consumers do not make complaints (particularly in the prevailing rental market) for fear of experiencing retaliatory action such as eviction and therefore require additional consumer protections to be in place.

Appropriately robust compliance and enforcement will require adequate reporting, monitoring and education. This must include ensuring that consumers in embedded networks know what their rights are, what expectations they should have and how they can seek enforcement.

PIAC supports EWON being authorised to refer potential pricing breaches to IPART. We note EWON has supplied IPART with a submission to the draft report which details some issues that need to be resolved to appropriately resource and enable EWON to carry out this function.

The final decision on the compliance and enforcement framework must ensure that applicable penalties are high enough to be a deterrent, not just a cost of business.

## **7. Future of hot and chilled water embedded networks**

PIAC does not support embedded networks in their current form. However, we do not preclude the possibility that appropriately regulated embedded networks can help enable good consumer outcomes. For instance, where space limitations or building density mean that it is more practical and efficient to provide centralised services, i.e. there is not enough space for individual water heaters and/or air conditioning compressors.

PIAC broadly supports Draft Recommendation 19 not to prohibit new hot and chilled water embedded networks in NSW. However, any future for embedded networks (including hot and chilled water embedded networks) must squarely place the onus on the proponent to demonstrate what tangible beneficial consumer outcomes will be realised as a result. This should be accompanied by robust regulation to ensure equivalent consumer rights and protections are also delivered. PIAC supports IPART making explicit recommendations to reflect this.

### ***Recommendation 3***

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*That embedded networks (including hot and chilled water embedded networks) be explicitly limited to circumstances where the proponent can demonstrate a tangible benefit(s) residents are guaranteed to receive (and which can be monitored). This should be subject to robust regulation to ensure equivalent protections and rights for residents. Where such regulation is not pursued or regarded as impractically difficult, NSW should move to ban embedded networks and unwind existing arrangements.*

PIAC is unaware of any consumer benefits of non-centralised hot water embedded networks. Unless there are demonstrable consumer benefits, they should be banned.

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**Recommendation 4**

*Ban non-centralised hot water embedded networks.*

PIAC strongly supports prohibiting gas embedded networks in new developments. Banning new gas embedded networks will help to ensure that consumers are not left with the expensive, polluting and increasingly outdated technology. An immediate moratorium and ban on gas embedded networks ensures the challenge of embedded network zero-carbon energy transition is only as big as it is today. This is an important consideration, given the expense and complications that can be involved in retrofitting many gas-embedded network arrangements.

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**Recommendation 5**

*An immediate moratorium and ban on new gas embedded networks.*

PIAC supports Draft Recommendation 20 that the NSW Government consider imposing additional disclosure requirements to improve consumer awareness for prospective purchasers and tenants.

## **8. Review and next steps**

PIAC recommends the following next steps to ensure embedded networks are delivering genuine benefits to NSW consumers:

- The NSW Government and/or IPART action all remaining aspects of the Embedded Network Action Plan to ensure better consumer protections for embedded network customers.
- IPART conduct an annual review into embedded network pricing to ensure the methodology is fit-for-purpose.
- IPART conduct a full review after two years to ensure desired outcomes, such as incentivising efficiency of systems and improving consumer outcomes, are being achieved.
- The NSW Government and/or IPART schedule a regular inquiry regarding what types of embedded networks are developing and how to regulate these to ensure good outcomes for consumers and the NSW net-zero strategy.

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**Recommendation 6**

*That the NSW Government and IPART consider the reviews and next steps outlined by PIAC in deriving genuine consumer benefits for embedded network customers in NSW.*

## **9. Continued engagement**

PIAC welcomes the opportunity to meet with IPART and other stakeholders to discuss these issues in more depth.