Embedded Network in your Strata Building – Things You Need to Know

Embedded electricity networks are becoming more and more common in strata buildings. They have also become common in other situations, such as commercial buildings, retirement villages and caravan parks, but this article will focus on strata buildings. Similar arrangements for other services, such as gas, hot water, air conditioning, internet access and storm water have also become common, but this article will focus on electricity.

It is becoming very common for developers to have strata buildings constructed so that there is a "parent" or "gate" meter between the infrastructure forming the national electricity grid and the meters of individual lot owners. This creates a private network, known as an "embedded network", through which an "embedded network service provider", acquires energy supplied by an authorised retailer and on supplies electricity to "embedded network customers". The most common scenarios we see are:

- Where the owners corporation is the owner of the embedded network infrastructure and is the embedded network service provider, the embedded network customers being the lot owners and tenants in the scheme. In this case, the owners corporation usually engages a specialist energy company to provide assistance.

- Where the embedded network infrastructure is owned or leased by a specialist energy company, which acts as embedded network service provider, the embedded network customers being the owners corporation in relation to common property consumption and lot owners and tenants in relation to lot consumption.

This can have many advantages for developers, including lower infrastructure costs, those relating to the embedded network typically being borne by the energy company and the marketing advantage deriving from the ability to claim that an embedded network facilitates efficient and cost effective electricity supply.

However, this has proven problematic for many embedded network customers, the common perception being that lot owners have become captive customers paying the maximum permitted charges. This has been compounded by the rapid growth in the number of such networks, in the context of a growing realisation that customers of such networks are being disadvantaged in terms of price competition and consumer protections, as compared with normal retail customers.

This has led to a number of reviews and in turn to a number of reforms. Important reforms commence on 1 December 2017 and further reforms are expected in the future. The purpose of this article is to consider, for NSW strata schemes, how this works, what changes are coming and what you can do if you are having problems in your building.

Key features of the regulatory framework are:

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- Under the National Electricity Law (NEL) and the National Electricity Rules (NER) the operator of an embedded network must be registered or have an exemption ("Network Exemption") in relation to operation of the network from the Australian Energy Regulator (AER) under the Network Service Provider Registration Exemption Guideline - December 2016 ("Network Guideline") and have a retail authorisation or an exemption ("Retail Exemption") in relation to sale of electricity through the network from the AER under the Retail Exempt Selling Guideline -- March 2016 ("Retail Guideline").

- There are many exemption categories and the appropriate one to use, where required, will depend on a number of factors, including the type of scheme and number of lots. Where the owners corporation is the embedded network operator, the key issue for the owners corporation is that these exemptions are dependent on ongoing compliance with various conditions, failing which the operator could be operating the network illegally and be exposed to substantial penalties.

- The conditions attached to the exemptions held by the embedded network operator will include various customer rights, including permitted charges, billing & payment arrangements, dispute resolution, cooperation with customer choice of an alternate retailer (including allowing use of meters and other embedded network infrastructure on reasonable terms) and restrictions on what can be charged to a customer who makes that choice. In practice, these rights can be hard to exercise, due to technical difficulties, costs and retailer reluctance to supply to customers in embedded networks.

- Following the so called "power of choice" review, the rules have been changed to give customers greater opportunity to choose their energy retailer. As from 1 December 2017, most schemes operating an embedded network will need to appoint an embedded network manager ("ENM"). The AEMO will accredit ENMs and maintain a register of ENMs. The role of the ENM is to address technical issues presenting barriers to retail competition, which should in turn lead to more competitive pricing by operators of embedded networks. Functions could include provision of market interface services and ensuring suitable metering installations and procedures.

- Further reforms are likely. In 2017, the AEMC conducted its "Review of regulatory arrangements for embedded networks". A draft report was published on 12 September 2017 and its final report is expected on 28 November 2017. These indicate that the following reforms are likely:

    - Increased powers for the AER to monitor and enforce exemption conditions.

    - Existing embedded networks would not transition to the national framework and would continue to be regulated under a modified exemption framework.

    - New embedded networks would transition to the national framework and the supply of electricity to small residential and business customers would be restricted to registered embedded network service providers and authorised retailers whose suitability and capability to provide these services would be assessed by AEMO and the AER.

- The Energy and Water Ombudsman NSW ("EWON") can receive and deal with complaints by embedded network customers. However, EWON decisions on complaints by customers of

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embedded networks will only be enforceable against embedded network operators who are EWON members, exempt sellers not being required to be members.

Another important issue in this area concerns common law and equitable principles relating to secret profits and secret commissions, as considered by the NSW Supreme Court in *Community Association DP 270180 v Arrow Asset Management Pty Ltd [2007] NSWSC 527*. In that case, the Supreme Court found that a developer owed fiduciary duties to a community association and prospective lot owners, analogous to those owed by the promoter of a company and had breached those duties by committing the association to a management agreement which was not on commercial terms and in relation to which the developer received a large secret fee, which was not disclosed to community association and prospective lot owners. The developer was ordered to account to the association for the secret fee.

It is not a long leap to argue that a developer who receives a benefit from a prospective embedded network operator, whether a payment or assumption of part of the infrastructure construction costs associated with the development, must disclose that benefit to the owners corporation and prospective purchasers of lots, failing which the owners corporation may be able to recover, from the developer, an account of profits (the benefit), equitable compensation for the amount by which embedded network costs exceed market rates and compensation for unfunded debts incurred during the initial period.

It does not follow that an owners corporation will be able to terminate the embedded network arrangements, i.e. any contractual arrangements between the owners corporation and the energy company and the lease of common property under which energy company owned embedded network infrastructure is situated on common property, which can survive registration of the strata plan pursuant to Section 24(2)(c) of the Strata Schemes Development Act 2015. It may be possible in some cases, e.g. where there has been fraud or misleading conduct by the energy company, but the specific statutory protections available in relation to management and caretaker agreements will not apply.

If you are having difficulties with an embedded network in your scheme, you have options and we can help you with those. In particular:

- The operator of the embedded network may not be complying with conditions giving you rights, which could be enforced.
- You may be able to improve access to retail competition by requiring appointment of an ENM.
- You may be able to resolve disputes through the operator's dispute resolution procedures or a reference to EWON.
- It may be possible to terminate or restructure the embedded network arrangements.
- It may be possible to pursue the developer for an order to account for any secret profit and an order for equitable compensation.

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Key takeaways

- Embedded networks are increasingly common in strata buildings, providing cost advantages for developers.
- Lot owners in embedded networks often face higher charges and fewer consumer protections compared to standard electricity customers.
- The regulatory framework for embedded networks includes requirements for registration and exemptions from the Australian Energy Regulator.
- Ongoing compliance with exemption conditions is crucial for owners corporations operating embedded networks.
- Recent reforms aim to address the disadvantages faced by customers of embedded networks.

****The information contained in this article is general information only and not legal advice. The currency, accuracy and completeness of this article (and its contents) should be checked by obtaining independent legal advice before you take any action or otherwise rely upon its contents in any way.*

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