30 August 2017

Ms Michelle Groves
Chief Executive Officer
Australian Energy Regulator
GPO Box 520
Melbourne Victoria 3001

Dear Ms Groves,

Australian Energy Council draft submission on applications for waiver from the Distribution Ring-Fencing Guideline

The Australian Energy Regulator (**AER**) has invited interested parties to make submissions on 11 applications it has received from Distribution Network Service Providers (**DNSP**) for waiver of obligations under the Distribution Ring-Fencing Guideline (**Guideline**).

The Australian Energy Council (**Energy Council**) welcomes the opportunity to participate in the AER's consultation on the waiver applications. The Energy Council represents 21 major electricity and downstream natural gas businesses operating in competitive wholesale and retail energy markets.[1] These businesses collectively sell gas and electricity to over 10 million homes and businesses.

The Guideline is of particular interest to members of the Energy Council as it facilitates a level playing field as between DNSPs and competitors in seeking to provide innovative and customer-driven services in energy (and other) related areas. To this end, the Energy Council considers that:

1. Waivers should only be granted in exceptional circumstances.
2. These circumstances must be adequately justified.
3. A waiver must not extend in scope or in time further than reasonably necessary.

These threshold criteria have not been met by all parties who have recently applied for a waiver under the Guideline.

Compliance with the Guideline as a rule—not the exception

In order for end-users to benefit from services that are capable of dynamic competitive offerings, it is essential that there is non-discriminatory access to these markets. Adherence to the principles set out in the Guideline play a crucial role in this regard. As noted in the Guideline Explanatory Statement (p 1):

[1] The retail business Ergon Energy Queensland Pty Ltd (EEQ) does not participate in the Energy Council's working group on ring-fencing and is not represented in this submission. Aurora Energy has abstained from supporting this submission, and has provided its own submission directly to the AER.

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> The objective of ring-fencing is to provide a level playing field for third party providers in new and existing markets for contestable services, such as those for metering and energy storage services, in order to promote competition in the provision of electricity services. Without effective ring-fencing, DNSPs would hold significant advantages in such markets.

For the above reason, any application for waiver from the obligations in the Guideline must be critically assessed. The default position must be compliance with the Guideline as a rule—not the exception. An applicant for waiver must put forward a reasoned basis for the waiver to be granted. Issues of convenience or protecting access to economies of scale and scope are not reasons for a waiver to be granted. The Energy Council agrees with the following observation made by the AER with respect to waivers from the Guideline obligations (Guideline Explanatory Statement, p 6):

> We wish to make clear that we do not see the availability of waivers as representing a business-as-usual approach. We consider that the waiver criteria are likely to be met only when alternatives are inappropriate. That is, waivers are an exceptional measure only, and DNSPs will normally be expected to achieve compliance with the Guideline's obligations. Nonetheless, we also recognise that especially in the initial period of the Guideline's operation there may be need for waivers, particularly to transition DNSPs to their next distribution determination when service classifications may be amended.

This submission first sets out some general observations on the waiver applications. Some more specific comments are then made on a number of the individual applications for waiver.

General observations

Apparent lack of genuine steps to become compliant

The applications that are the subject of this submission have been received from:

- ActewAGL Distribution
- Ausgrid
- AusNet
- Endeavour Energy
- Energex
- Ergon
- Essential
- Jemena
- SA Power Networks
- TasNetworks
- United Energy

These waiver applications were variously received by the AER between 27 July and 2 August 2017.

The Guideline commenced on 1 December 2016, and was preceded by an 11-month development and consultation period. The transitional arrangements (clause 7.1(a)) provide that a DNSP must fully comply with each of the obligations in clauses 3 and 4 of the Guideline in respect of its existing services "as soon as reasonably practicable, having

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regard to the likely costs of having to fully comply with those obligations any sooner, but in any event must fully comply with those obligations by no later than 1 January 2018".

It is extraordinary that these waiver applications have only been made now – some five months before compliance with the Guideline is required, and only after apparent prompting by the AER to provide any waiver applications. Given the extent of some of the waiver applications sought, it is apparent on the face of the applications that a number of DNSPs have not undertaken any, or sufficient, steps to bring themselves into compliance with the Guideline. This appears to have led, in turn, to a number of what have been termed as "transitional" waivers being sought, to provide an additional period of time for the DNSP to bring itself into compliance with the Guideline. The Energy Council considers that where an extension of time is requested to make arrangements in order to become fully compliant with the Guideline, the grant of any waiver should be conditional on a clear identification of the steps to be taken, the timeline for these, and reporting to the AER against that timeline.

No real attempt to quantify costs if waiver not granted

None of the applications requesting a waiver make any real attempt to quantify the costs that would be incurred if the waiver was not granted. The *nature* of the costs is often generally identified, but no serious effort has been made in any of the applications to provide at any level of detail the quantum of the costs associated with compliance. This makes it difficult to practically assess the appropriateness of the exemption sought, and if it is to be granted, the length of time it should remain in operation.

Waiver on the basis of a future change in service classification

A number of the waiver applications have been made on the basis that there will be, or there is likely to be, a change in the classification of the services provided by the DNSP in the future. The AER has noted that it may only be appropriate to provide a waiver in such circumstances where a "prima facie case for classification change" has been demonstrated.[2]

The Energy Council considers that where an applicant for waiver can demonstrate that there will be, or there is a high likelihood that there will be, a change in the classification of a service in a forthcoming regulatory control period, this provides a reasoned basis for waiver to be sought. As noted by the AER in the Guideline Explanatory Statement however, this consideration is of particular relevance during the initial period of the operation of the Guideline. The Energy Council would anticipate that the necessity for such waivers to be sought will significantly fall away over the next two to three years.

Applications for waiver such as those made by Ausgrid, Endeavour Energy, Essential Energy and TasNetworks, have been made on the basis of the likely proposed classification of services to apply during the 2019-24 regulatory control period. The AER published the final Framework and Approach paper for these DNSPs for the regulatory control period commencing 1 July 2019 in July 2017. This provides considerable certainty as to the classification of services for that regulatory control period, as the classification of distribution services must be as set out in the framework and approach paper unless there are unforeseen circumstances that justify a departure from that classification (National Electricity Rules, clause 6.12.3(b)). On this basis, these DNSPs have put forward a reasoned basis for waiver on the basis of a future change in service classification. This can be contrasted with the SA Power Networks application for waiver in which no attempt is made to identify the

[2] Referred to in a letter from CitiPower / Powercor to the AER dated 7 June 2017 (p 3), which restates questions from the AER to CitiPower / Powercor in respect of their waiver applications.

services that might be reclassified—an exemption has simply been sought for all of them. This is clearly unsatisfactory.

Waiver should only cover what is necessary

A number of the applications for waiver are made in respect of similar services. For example, AusNet, Jemena and United Energy each seek a waiver relating to:

- alteration and relocation of distributor public lighting assets
- new public lights (new lighting types not subject to a regulated charge and new public lights at greenfield sites)
- reserve feeder construction
- emergency recoverable works
- installation, repair and maintenance of watchman lights

One reason given by the DNSPs as to why the waiver sought should be granted is because there are some aspects of the services that can only be provided by the DNSP. For example, works that are required in the 'no go zone' where only the DNSP can undertake the works (provision of watchman lights), and the tie-in works and upstream augmentation associated with reserve feeder construction. Another reason given in support of some of the waiver applications is that the relevant DNSP does not actively promote these services. However, despite these matters being raised in support of the grant of a waiver, the scope of the waiver that is sought is not necessarily aligned with these matters. For example:

- United Energy's application for waiver extends to all of clause 4.2 of the Guideline, which would include 4.2.3(a)(ii) (cross-promotion) where United Energy's application provides that it does not actively pursue services such as installation, repair and maintenance of watchman lights and new stand alone and green field public lighting;

- AusNet, Jemena and United Energy have sought exemptions in respect of the services generally without identifying precisely the nature of the service that can only be provided by the DNSP and limiting the waiver to those activities. A good example of this is the installation, repair and maintenance of watchman lights. Any waiver should be drafted in a manner that strictly limits its application to works that can only be undertaken by the DNSP.

In connection with the services that appear to be variously referred to as "night watchman services" or "nightvision", the Energy Council notes that the final Framework and Approach for the NSW DNSPs provides that the proposed classification for a service entitled "security lights", described as "customer requested flood lighting services" for the 2019-24 regulatory control period is alternative control (potentially contestable). To the extent this proposed classification is adopted, or any waiver granted in respect of the applications for wavier made in respect of this service by any DNSP, the description does not appear to be adequate. The description should be clear that it is customer requested flood lighting services where the request is that the services be provided by means of equipment installed on the distribution network.

Specific observations

Energex

<u>Novation of contracts to Energy Impact (the affiliated entity)</u>

Energex submits that lead times and preconditions for the novation of contracts associated with the delivery of other services to Energy Impact is likely to mean that Energex will not be

able to effectively transfer services, and therefore comply with the legal separation obligations for some other services by 1 January 2018. It is unclear from Energex's application (p 10) if it is seeking an exemption for three months or six.

Given the time Energex has had to bring itself into compliance with the Guideline it is disappointing that many of the steps that are identified in Table 2-1 "High Level Implementation Plan" on page 11 of Energex's waiver application have not already been completed or apparently started (for example, review of contract terms and conditions). Given this, if the AER is to grant the waiver application it should be subject to conditions that Energex report to the AER on the progress of the various milestones and novation of contracts. Otherwise there appears to be a real risk that, as Energex indeed notes on page 10 of the waiver application, Energex may seek a further extension of the waiver.

Energex also seeks a waiver from branding separation obligations relating to instances where staff perform services which are contestable electricity services. The waiver is sought on the basis of claimed "practical challenges and constraints" associated with introducing new branding. Energex claims that as a consequence of significant challenges associated with rebranding uniforms and fleet, Energex "will not" be able to fully comply with the branding obligations for uniforms and fleet until 30 June 2025.

The Energy Council considers that length of the waiver sought is inappropriate and that the challenges and difficulties alleged by Energex are significantly overstated.

Energex claims that it has "only recently" completed a consultation process to introduce new uniforms. Given that the Guideline commenced on 1 December 2016, following a lengthy period of development and consultation, Energex does not explain why it is that a consultation process to introduce new uniforms that has only been "recently completed" was not conducted with a view to the branding obligations in the Guideline. Further, while it is understandable that given the environment in which employees work, the uniforms are of a specialised nature, most of those considerations would relate to the design of the uniform and materials used—not considerations as to branding. In this connection, Energex appears to have overstated what would be required to bring itself into compliance with the branding obligations with respect to employee uniforms.

The considerations discussed above relating to employee uniforms do not appear to have any application to the branding of fleet. Energex does not identify any challenges with the rebranding of fleet.

Energex does not seek to describe or calculate the costs associated with complying with the Guideline in respect of branding for uniforms and fleet. Energex simply states that it has made a significant investment in Energex branded uniforms, which means "it is most cost effective for this supply of uniforms to be exhausted before new uniforms are acquired". With respect, while a relevant consideration, what might be "cost effective" for Energex is not to the point. If that served as the guide for when a waiver from the Guideline should be granted, the Guideline would have little relevance. It is not the case that the existing investment in Energex branded uniforms would be wasted. Those stocks would continue to be utilised by, and presumably exhausted by, Energex employees.

On the basis of the information provided by Energex, the AER should not be satisfied that it is appropriate to grant the waiver, including because Energex has not undertaken any serious attempt to identify the costs that it would incur in complying with the Guideline. Particularly given the length of the exemption sought, it is incumbent on Energex to demonstrate that it in fact faces challenges in complying with the branding obligations for both uniforms and fleet.

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Ergon

Similarly to Energex, Ergon Energy is seeking a waiver from:

- the legal separation obligations that apply to the other services listed in its waiver application for six months to allow Ergon Energy to continue to provide these services for six months until the contracts are novated; and

- branding separation obligations relating to instances where staff perform services that are contestable electricity services on the basis that there are a "range of practical challenges and constraints associated with introducing the new branding".

With regards to the above matters, the Ergon Energy waiver application suffers from the same deficiencies as the Energex application, identified above.

In addition, Ergon Energy is seeking a waiver from the branding separation obligation for retail services provided by Ergon Energy Queensland (**EEQ**). Ergon Energy states that under the proposed waiver, EEQ and Ergon Energy could both continue to use the Ergon Energy brand, with the "trigger" for the waiver coming to an end being changes to the legislative framework in Queensland to remove EEQ's inability to offer market contracts to all market customers in Queensland.

Ergon Energy describes EEQ as a "non-competing retailer", however, that is something of a misnomer. While EEQ may be unable to actively attempt to acquire new customers or provide them with services pursuant to a market contract, this does not mean that EEQ is restricted from providing behind the meter services both in the Ergon Energy network area and anywhere else in the National Electricity Market. As such, the "trigger" for the waiver coming to an end should be when EEQ begins to offer solar or any other behind the meter services to retail customers, not changes to the legislative framework in Queensland.

The AEMC 2016 Retail Competition Review Final Report, 30 June 2016, highlights the significant challenges faced by new entrant retailers, in particular in regional Queensland, although the main impediment remains how the uniform tariff policy is implemented. The report (p 18) found that Ergon Energy supplies electricity to almost all of the regional Queensland market, serving approximately 733,000 small electricity customers. The AEMC report noted that there is no rivalry for residential customers and there is no price-based competition. Therefore, while EEQ is restricted to making market offers, this does not mean that they are a non-competing retailer. By virtue of EEQ's incumbency and presence in the market, they are a competing retailer. Adherence to the branding requirements of the Guideline will assist in facilitating a more competitive environment as and when policies directed at improving retail competition in regional Queensland are introduced.

Essential Energy

Amongst other services, Essential Energy seeks a waiver for residual type 4 contestable meters. Essential Energy states that it is likely to retain ownership of a small number of contestable type 4 meters after 1 January 2017 and that Essential Energy is reliant on retailer action for their transfer. We consider that this is a relatively minor issue in both volume and customer impact and does not require a waiver. Under the new rules, note that Essential Energy can classify all their type 4 contestable meters as 'non-compliant' on 1 December 2017, and therefore place an obligation on retailers to exchange the meters and promptly appoint a metering coordinator. As such, we consider that any remaining meters on 1 January 2018 could be managed via letter of no action instead of a waiver process.

SA Power Networks

The SA Power Networks application falls well short of providing any reasoned basis for a waiver to be granted, as such, the AER should not grant it. The waiver application by SA Power Networks relates to all negotiated distribution services currently allowed to be offered and provided by SA Power Networks, with the exception of type 1-4 metering. The waiver is sought with respect with respect to the functional separation obligations in section 4.2 (offices, staff, branding and promotions) and clause 4.4.1(a). The proposed expiry date for the waiver is 30 June 2020, based on the expectation that "most, if not all, of SA Power Networks' [negotiated distribution services] will be reclassified from 1 July 2020".

The AER could not be satisfied on the basis of the application made by SA Power Networks, that it would be appropriate to grant the waiver sought. SA Power Networks makes no attempt to even identify those negotiated distribution services that may be likely to be reclassified from 1 July 2020, let alone provide a "prima facie" case for classification change. Further, the other reasons given by SA Power Networks for the waiver go more to matters of convenience, as well as protecting access to economies of scale and scope in providing direct control services and negotiated distribution services. SA Power Networks also makes no attempt to provide any details of the costs associated with compliance if the waiver was not granted. The SA Power Networks application falls well short of providing any reasoned basis for a waiver to be granted.

TasNetworks

The waiver application from TasNetworks raises particular concerns in the "temporary" waiver sought from the legal separation provisions of the Guideline, which would permit TasNetworks to provide distribution and transmission services in conjunction with other services. The waiver is sought for six months on the basis that more time is required to establish the separate legal entity that would provide these services. The services are not described in any detail that would permit analysis of the potential effect of granting the waiver. Three of the services are merely described as: external telecommunications; external data centres; and external IT services.

As noted above, the DNSPs have had considerable notice and time to make the necessary arrangements to bring themselves into compliance with the requirements of the Guideline. It appears from TasNetwork's waiver application that virtually no steps have been undertaken to implement legal separation, despite being under an obligation to comply with the Guideline as soon as reasonably practicable. That obligation has existed since 1 December 2016. Similarly to the comments made with respect to Energex on the novation of contracts, if the AER is to grant the waiver application it should be subject to conditions that TasNetworks report to the AER on the progress of the various milestones.

Further information

Should you have any questions in relation to this submission please contact David Markham, telephone 03 9205 3111 or david.markham@energycouncil.com.au.

Yours sincerely,

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