

A few
words.

23 February 2012

Mr Chris Pattas
General Manager
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Submitted via email to [AERInquiry@aer.gov.au](mailto:AERInquiry@ aer.gov.au).

Dear Mr Pattas,

AGL Energy welcomes the opportunity to comment on the Discussion Paper on "Electricity Distribution Ring-Fencing Guidelines Review", issued by AER on December 2011 (Review).

AGL Energy (AGL) is one of Australia's largest energy company that operates across the supply chain including investments in electricity generation and electricity retailing. AGL has over 3 million retail customers and operational control of some 3,000MW of generation capacity in the National Electricity Market (NEM).

AGL supports AER's view that ring-fencing and guidelines help limit the ability of vertically integrated DNSPs to discriminate against upstream and downstream competitors and is desirable. AGL shares AER's concerns that currently there is not a single set of national guidelines and there has been limited review of the guidelines.

AGL supports a single set of national guidelines to be developed. A national guideline would provide consistency of applications and improve the effectiveness of the regulatory outcome for retailers, especially those with a national coverage like AGL. In AGL's view, the differences in jurisdictional guidelines is primary a legacy issue rather than an outcome of best regulatory practice. Having a national guideline would be entirely consistent with the on-going reform in developing a national regulatory regime over the last ten years or so. Hence, AGL would welcome a move to a single set of national distribution ring-fencing guidelines.

AGL considers it critical that a distribution ring-fencing guidelines be retained, improved and enforced effectively. AGL is of the view that distribution ring-fencing guidelines is an important element of the regulatory instrument that supports the National Competition Policy (NCP) objectives. The NCP and the subsequent energy market reform clearly support the separation of natural monopoly markets (distribution) from contestable markets (retail) and the creation of conditions for competition in contestable markets. This arrangement of market separation continues to be even more relevant with the emergence of smart meters and smart grids that may provide the opportunities for distribution businesses to provide services that are considered to be contestable in the retail market. AGL is of the opinion that any national guidelines be developed on the basis that it is effective in dealing with the competition issues that may arise from a distribution business providing any services that are contestable.

AGL agrees with AER's view that an effective means of preventing problems associated with the integration of distribution businesses and other competitive elements of the electricity supply chain is necessary in the NEM. While ring-fencing had played an important part in mediating the risk associated with distribution business owning a retail business, AGL believes it requires a strong enforcement regime for it be effective. In AGL's view, unless an effective compliance regime, including regulatory incentive and/or penalty and reporting requirements, is implemented, the desired outcome of ring-fencing provisions in discouraging anti-competitive behaviours may be compromised.





A detailed response to the questions raised in AER's discussion paper is provided in the Appendix.

Please contact Kong Min Yep on 03 8633 6988 for further information regarding this submission.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Alex Cruickshank', is positioned below the text 'Yours sincerely,'.

Alex Cruickshank
Head of Energy Regulation

Appendix

Is ring-fencing an appropriate means of addressing the problems that vertical integration of DNSPs may give rise to? If not, what is an appropriate regulatory method?

AGL is of the view that ring-fencing is appropriate in mediating the risk of anti-competitive behaviour of a vertically integrated DNSPs participating in the contestable market.

AGL believes that previously, ring fencing has provided a reasonable outcome over the control and monitoring of the separation in distribution and retail businesses. However, with the changing market structure and emerging market in contestable services, AGL believes that it is critical for an effective compliance regime to be considered as part of the Review to maintain the highest level of confidence and transparency in ring-fencing provisions. AGL notes that compliance with ring-fencing is currently not a civil penalty provision. In AGL's opinion, penalty and/or incentives or both should be part of a compliance regime.

Additionally, the application of ring-fencing provisions to transitional arrangement of distribution and retail business is unclear, and should be addressed as part of the Review. As an example, AGL is aware of the potential confusion for new customers when distribution business's connection documents contain details of local retailers and there is no clear distinctions between supply and connection process. This has the effect of reducing customer's choices of retailer and reduces competition during the transitional period. In another example, it was also unclear if a flat rate associated with the rollout of interval meters by a distributor was offered to all retailers or only the local retailers. At the very least, AGL believes that there should be a fixed period within which any ring fencing compliance issues should be resolved and customers advised of the potential confusions over that period.

Is a national set of Distribution Ring-Fencing Guidelines desirable under the current regulatory framework? Are the current guidelines and provisions of the CCA sufficient to deal with the issues that vertical integration poses?

AGL supports the provision of ring-fencing in the NER and AER's role in developing and enforcing the guidelines as a national regulator. There is scope that the provision could be subject to a civil penalty provision to reinforce the compliance requirements, thereby recognising the critical nature of distribution ring-fencing requirements in achieving the NCP objectives and maintaining the progressive market reform thusfar. This is particularly relevant with the emergence of smart meters and smart grids where the distinction between monopoly and contestable services are less clear. AGL believes that with significant investment in smart technology already committed in Victoria and NSW, and more are under consideration from other states, and the expressed desire of the distribution business to promote them as a key enabler in network services, it becomes more critical that ring-fencing provisions could ensure a clear separation between regulated and unregulated activities within the distribution business. AGL believes that further consideration should be given to a compliance regime that promotes behaviour that does not diminish the benefits that are derived from the competitive nature of retail

businesses. A single set of national ring fencing requirements and guidelines would certainly improve the efficacy of the implementation.

AGL concurs with AER's view that the competition protection provisions in CCA may not be sufficient in mediating the particular risk arising from an integration of distribution business with contestable activities in electricity market. This is of concern to AGL, as indicated in the AER's paper, that CCA does not specifically prohibit the co-ownership of distribution and contestable businesses in the electricity market. As outlined in the paper, it would appear the CCA competition test may not detect any anti-competitive issues that would be considered a breach under the existing ring-fencing provisions. AGL is of the view that it is prudent to retain the current regulatory framework that provides specific protection for retailers from any potential anti-competitive behaviours arising from the integration of distribution business with a contestable activities in the NEM.

AGL is concerned that the current regulatory arrangement does not allow AER to amend the ring-fencing guidelines for the distributors in Victoria as per NER requirements. As indicated in AER's paper, the ESCV would need to revoke the existing Victorian-based guidelines in order to adopt a national guidelines. AGL sees this as unnecessarily inefficient given the fact that the jurisdictions were transitioning to NECF as of the 1st July 2011, and the role of the ESCV post 1st July 2011 is uncertain. AGL believes that it is necessary for this anomaly to be resolved as jurisdictional responsibilities continue to be transferred to AER as a single national regulatory authority in the near future.

Are the existing jurisdictional guidelines still appropriate in light of recent developments in the industry structure and the regulatory framework governing DNSPs? If not, why?

AGL believes that any new national guidelines would need to recognise that much has changed in the NEM market. While the merits and experience gained from the existing guidelines would provide a valuable base, the new national guidelines must consider the wider scope and nature of all unregulated activities and ensure the intent of an effective structural separation can be duly effected.

This is important as most of the distributors and retailers are now separately owned, and there are new services arising from the significant commitment and investment on smart technology by distributors, retailers and governments.

Are there any problems with the content of the current jurisdictional guidelines? In what ways could they be improved?

AGL notes that ESCV had removed the non-discrimination provision in clause 20.1 of each of the electricity distribution licence and replaced it with a broader provision that was included in the electricity ring-fencing guideline. The non-discrimination provision is a critical part of the Victorian-based guidelines which AGL supports. This particular provision highlights the need for AER to carefully consider the variations between all the jurisdictional-based guidelines and ensure the intent of the provisions are carried across to the national guidelines. As indicated before, AGL is concerned with the uncertain role of ESCV post 1st July 2011, the ability for AER to amend/develop new guidelines is an issue that should be addressed.

Should the AER work to develop a set of national guidelines that apply consistently across all participating jurisdictions?

AGL strongly supports AER working to develop a set of national guidelines that apply consistently across all participating jurisdictions. Among other reasons indicated before, the introduction of NECF and the move towards national rules, it is more effective for the regulations on distribution and retail to fold under the national regulatory regime.

If not, how should the inconsistencies across jurisdictional guidelines be dealt with?

While AGL does not support inconsistent guidelines across the jurisdictional, if any inconsistency must exist, some form of grandfathering arrangement could be considered under a set of standard national guidelines, with the expectation that over a fixed period of time, the inconsistencies are eliminated to conform to the standard national guidelines.

Does the current structure of the NEM mean that distribution ring-fencing guidelines are no longer necessary?

The distribution ring-fencing guidelines were developed during full retail contestability in each state. Whilst the issues may be different, the requirement to ensure that businesses operating in regulated monopoly industries do not use their monopoly power, or collude with associated businesses, to give associated businesses an unfair advantage over their market competitors.

In opening up the energy market to greater competition and the development of new services that are enabled as part of a smart meter rollout, it is important that the separation of prescribed services (monopoly services) from non-prescribed or excluded services (contestable services) is effective. New entrants into the contestable services market will be able to compete on a fair and equal basis and without fear. It is important that the monopoly elements that are subject to economic regulation are clearly defined and that costs associated with monopoly activities are separated from costs related to contestable activities to ensure that there is no distortion of cost recovery.

While AGL believes economic regulation does consider the issue of regulated and unregulated revenue, it is unclear if it would capture all potential anti-competitive behaviours that may result in the distortion of competitive market. In AGL's opinion, an independent competitor is vulnerable to the potential unfair advantage a distributor might derive from owning a competitive business. Hence, in AGL's view, unless there is some form of deterrent and active scrutiny over the potential anti-competitive practices and behaviour, there could not be much confidence that it may not occur. AGL believes that ring-fencing provisions provide a positive assurance that such behaviour are monitored and provides transparency to all participants in the market.

How should distribution ring fencing guidelines be modified to account for changes in the electricity supply industry?

The NEM has evolved, and continues to evolve, since the existing state-based guidelines were developed around full retail contestability. In AGL's opinion, a new national ring



fencing guidelines would need to recognise the fact that there are now greater scope for all existing players and new players to expand the range of services that are not envisaged in the early years of FRC. It is even more important that the new market has the opportunity to develop within a true competitive environment that would benefit the customers with lower cost and greater range of services and choices. The ring-fencing guidelines would need to be strengthened to ensure any risk of distributors distorting the competitive market through the ownership or access to an associate competitive business is appropriately scrutinised.

How should the generation of electricity by DNSPs to offset energy consumption be dealt with in any ring fencing guidelines? Should there be an exception to allow such consumption, should it be capped, or should it be prohibited?

AGL is comfortable with distribution owning or accessing generation for the sole purpose of consumption of plants or other assets regulated in the NER.

Do the current jurisdictional ring fencing guidelines inhibit effective innovation in the market for new contestable services? If so, how could a revised set of ring fencing guidelines address this?

AGL believes that ring-fencing provision and guidelines, if designed and enforced appropriately, would provide confidence to independent providers that competition is equal among all the potential providers. This environment would encourage innovation and risk taking that would ultimately benefit customer with greater choices and lower cost. In AGL's opinion, strong enforcement of the guidelines or changes to the compliance regime in the rule could help to improve the efficacy of the ring fencing provisions.