

18 January 2016

Mr Chris Pattas
General Manager
Network Investment and Pricing
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Dear Mr Pattas

Energex Application for a Ring-fencing waiver under the Electricity Distribution Ring-Fencing Guidelines

The Competitive Energy Association of Australia (CEA) welcomes the opportunity to make a submission to the Australian Energy Regulator (AER) in relation to the Application for a ring fencing waiver submitted by Energex Limited (Energex).

The CEA represents the policy positions of the Chief Executives of 22 electricity and downstream natural gas businesses operating in competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

Background

Developments in the National Electricity Market (NEM) with an increase in distributed generation and energy efficiency have challenged the traditional grid-based operational model. These developments have also created technical and economical challenges to network distribution business. In response network businesses are considering ways to reinvent their business and revenue models utilising developments in battery storage and solar PV¹.

Distribution businesses are funded by regulated revenue and so have a natural competitive advantage if they are permitted to apply that revenue to a competitive market activity or service. The concept of competitive neutrality demands that these parties separate what are considered contestable, market services from those that are rendered in monopoly markets. This application therefore raises some threshold issues regarding regulated network businesses moving into contestable services markets.

In October 2015 the Australian Energy Market Commission (AEMC) published a report into the regulatory implications of the Integration of Energy Storage. This report was explicit in respect to the need for robust ring fencing of regulated and competitive services by networks:

Network businesses should only be allowed to own storage behind the meter through an effectively ring-fenced affiliate that separates this activity from the provision of regulated network services. There are however a range of options available to them, through commercial arrangements with other service providers, to leverage the benefits of storage. The ring-fencing provisions that help define how regulated and contestable services are provided by network businesses are due to be revised by the AER. These will need to be developed with very clear

requirements for arms-length transactions and be accompanied by rigorous compliance and enforcement activities. This will enable networks to compete with other service providers on an equal basis.ⁱⁱ.

The AEMC made this assessment following detailed consideration of the potential value of battery storage in NEM and optimal regulatory models to deliver this value. The AEMC was supportive of utilising the competitive market frameworks to allow consumer preferences to drive how the battery sector develops.

Application of QCA Ring Fencing Guidelines

The QCA Ring Fencing Guidelines (“Guidelines”) were drafted in 2000 when battery and solar PV systems were not a commercial reality in the NEM. However, these are the parameters against which the AER must review the current application. Under the Guidelines a Distribution Network Service Provider (DNSP) must not carry on a related business within that entity without seeking a waiver. A related business is defined as the business of producing, purchasing or selling electricity.

The application argues that even though the Battery Energy Storage System (BESS) project will involve generation, Energex does not, “consider this carrying on a related business” because it is not, “in the business of producing electricity as there is no intention to make a profit”. We note that commercial intellectual property (“IP”) will flow from this project which could be of considerable value. To the extent therefore that this activity involves the introduction of electricity to the grid, it constitutes producing electricity and is therefore a related business.

Waiver Requirements

Section 21 of the Guidelines places the onus on the applicant to demonstrate, ‘that the administrative cost to the DNSP and its Associates of complying with the obligation outweighs the benefit, or any likely benefit, to the public’. Energex has not provided any evidence in this regard. This application cannot therefore be successful as it is currently drafted.

In any event, it is the CEA’s position that the administrative cost of ring fencing this activity will not outweigh the benefit to the public, given the significance of the market design principle that applies in this instance. A grant of waiver is therefore not appropriate.

Additionally, even if the AER agrees that this is not a related business, it is an excluded service under the Guidelines, as it is something other than a designated distribution service. The requirements of Sections 1(c) to (e) therefore continue to apply. There is no mention in the application as to whether Energex intends to comply with these requirements even if a waiver is granted under Section 1(b). Therefore, if there was to be a waiver of Section 1(b); there must then be a direction to Energex on its continued requirement to comply with Sections 1(c) to (e).

Proposed revision of ring fencing guidelines

We understand that the AER is undertaking a review of the Guidelines throughout 2016. This reflects the evolution of the electricity industry and the acknowledged deficiencies of current regulatory tools, including the QCA Ring Fencing Guidelines. The AEMC also recognised the need for a clear delineation between contestable and non-contestable services.

Given the significant developments in technology that have occurred since the Guidelines were drafted (and continue to occur), it is the CEA's view that as broad as possible a definition of competitive market services be adopted in drafting any new guidelines. Separation of monopoly services from competitive market services is an important principle that underpins the energy market in this country.

It would seem inappropriate and pre-empting the outcome of the AER's review to grant an exemption from existing Guidelines in this context. Further, should an exemption be granted in this circumstance other network businesses may seek similar exemptions prior to completion of the review therefore making any resultant changes to the guideline redundant.

Conclusion

The activity the subject of this application meets the criteria for ring fencing under the current Guidelines and the applicant has not provided a basis for the waiver of the requirement. Because of this the AER cannot grant a waiver and Energex must comply with Section 1(b) of the Guidelines.

A network business sees that efficiencies and synergies can be achieved in the operation of its network through battery technology. However, the public benefits, including wholesale market benefits, are broader so networks should partner with a retailer or other operator (though commercial contracts) to understand and realise them. The grant of a waiver for this activity would run counter to the principles for which ring fencing was established at the time of the formation of the NEM.

Any questions about our submission should be addressed to Panos Priftakis, by email to panos.priftakis@esaa.com.au or by telephone on (03) 9205 3115.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Alex Fraser', with a horizontal line underneath.

Alex Fraser
General Manager, Retail

ⁱ See: http://www.ena.asn.au/sites/default/files/ena_final_2015_webinar_deck_ann_burns.pdf

ⁱⁱ AEMC, Integration of Storage: Regulatory Implications, Draft report, 9 October 2015, Sydney, executive summary, page ii.