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Mr Sebastian Roberts
General Manager
Networks Regulation South
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3000

Email: AERInquiry@aer.gov.au

Dear Mr Roberts,

GRIDX APPLICATION FOR NSP EXEMPTION ISSUES PAPER

Thank you for providing CitiPower and Powercor with the opportunity to comment on the Australian Energy Regulator's (AER) Issues Paper *GridX Power Pty Ltd Application for Network Service Provider Exemption (Issues Paper)*.

CitiPower and Powercor believe the GridX exemption application raises a number of important issues which require addressing. For convenience each of these issues is raised under the questions proposed by the AER in the Issues Paper.

Is it desirable to determine GridX's application at this time? If not how should the resolution of GridX's application for exemption proceed?

The AER indicates that GridX proposes 'development activities' in other National Electricity Market (NEM) states and that the issues raised will therefore be relevant across for all NEM jurisdictions. CitiPower and Powercor consider that a consistent NEM market approach is the most likely to achieve the NEM market objective and therefore any exemption should only be considered in the context of the positions adopted by each of the NEM jurisdictions on this issue. This would also require that GridX first provide details of what is proposed in each jurisdiction, so that the implications for retail and distribution regulation can be assessed.

In Victoria the Essential Services Commission (ESC) is currently conducting a review into the appropriate form of regulation for small scale energy distribution and selling, prompted by a request from the Victorian Minister for Energy Industries and Resources. A report on this review is due by 30 September 2006.

While one of the objectives for this review is to address any inefficient regulatory barriers to market entry, the Minister also expressly referred to the issue of consumer protection and their access to retail contestability.¹

The GridX development model however clearly precludes retail contestability and would make it the monopoly provider of electricity, gas and hot water in its development areas. Exempting it from registration as a network service provider (NSP) would further this exclusion of full retail contestability as GridX, would not be obliged under the National Electricity Rules (NERs) to provide network access to competing retailers of electricity.

CitiPower and Powercor assume other NEM jurisdictions may be similarly seeking to address this important public policy issue and submit that the AER should not be approving GridX's application at this time and should do so in the context of an agreed NEM position on how to treat such developments.

As an interim position, the AER should formally adopt the NECA exemption guidelines pursuant to the transitional provisions of the NERs. The GridX application fails to meet key principles developed by NECA for assessing exemptions applications. The GridX proposal:

- (a) Is not wholly contained within premises owned or controlled by GridX.
- (b) The provision of network services (and any supply of electricity to other parties) is not incidental to the business of GridX. It is in fact core to GridX's proposed operations.
- (c) Does not provide standards or other regulatory controls with respect to GridX's operations.
- (d) Would limit the access of GridX customers to full retail competition.
- (e) Whilst maybe being constrained in New South Wales in terms of setting maximum energy charges for GridX customers unable to access alternate retailers, is not similarly constrained in other jurisdictions. Also such maximum charges may not be reflective of pricing in a competitive environment.
- (f) Does not provide appropriate recourse to dispute resolution procedures in jurisdictions other than New South Wales, given they would not be bound by the NER dispute resolution procedures and may not be subject to the ombudsman arrangements across each jurisdiction.
- (g) Does not contemplate exemptions from relevant jurisdictional licensing requirement. For example in Victoria under provisions contained in the *Electricity Industry Act 2000* GridX would be required to hold both an *Electricity Distribution and Retail Licence* or have applied to the ESC for an exemption.

As a consequence the GridX exemption application should be declined at this time.

Is the granting of an exemption for GridX likely to advance the NEM objective particularly, is it in the long-term interests of consumers with respect to price, quality, reliability and system security?

¹ Letter to ESC from Theo Theophanous MP dated 21 March 2006.

The basis of the NEM is predicated upon competition in the generation and retail sectors, with regulated access being provided to distribution and transmission services. Regulation is required only where the provider is a natural monopoly and actual competition cannot be efficiently or effectively introduced. The NEM jurisdictions have recognised this fact and dedicated significant resources to introducing full retail competition into the retail supply of both electricity and gas.

Retail issues

The GridX network configuration and business model is predicated upon the establishment of a horizontal energy supply monopoly within its development areas.

- (a) As pointed out in the AER Issues Paper, *‘there does not appear to be any technical reason for configuring the network to only allow export, but not the importation, of energy.’* It follows that, in the absence of any other explanation, the reason for this network configuration is to ensure a retail monopoly. Granting an exemption will serve to cement this monopoly, denying customers a right they otherwise would have had and hence can not be consistent with advancing the NEM objective.
- (b) In addition to monopoly supplier status in retail electricity, GridX also proposes that it be the monopoly provider of retail gas and hot water services. The scope of this proposed monopoly is therefore unprecedented, as commonly Australian retailers of electricity and gas have been constrained by the consumer’s ability to switch between fuel sources for heating, cooking and hot water. This competitive constraint will not exist in GridX’s development areas.
- (c) GridX points to existing jurisdictional regulation of retail electricity supply as perhaps providing adequate protection to consumers. In particular GridX refers to its application for a *New South Wales Electricity Retail License* as addressing any risk of it exploiting its monopoly power. The retail licensing regimes in all NEM jurisdictions are however designed for an environment in which retail contestability has been introduced and competition exists between electricity and gas.
- (d) Neither is it clear that GridX is in fact so constrained regarding pricing, it notes in its letter to the AER of 19 May 2006 that it *‘...is currently discounting energy bills in its first development below the rates offered by electricity retailers in other low emission or green energy offers.’* Green energy offers are generally priced at a premium by retailers so GridX’s statement regarding its pricing is not necessarily indicative of a service that is lower or even competitively priced with prevailing retail prices. Further, while moving consumers to low emission energy may in itself be to the greater good, doing so in the context of reducing consumer choice by only offering a higher priced (green) product does not promote the NEM objective.
- (e) GridX will also be in a unique position of being able to transfer price to unregulated services. For example, retail returns that may be constrained in electricity or gas may be added to charges for the provision of hot water.

Existing retailers are constrained by competition and the regulatory environment is commensurately more light-handed than might be appropriate for an entrenched monopoly provider of retail services.

Distribution services

In terms of distribution:

- (a) GridX points to its agreements with developers as being a constraint upon its distribution monopoly. Clearly the content of such agreements will vary from development to development, so no general reliance can be placed upon such future agreements. In addition property developers can in no way be seen as a proxy for regulation of distribution charges. Distribution tariffs are of minimal concern to developers as they are unlikely to significantly affect the value of the property and secondly, once the property is sold, the developer has no on-going interest in the property or the customer.
- (b) The majority of customers who purchase a property within GridX estates are unlikely to be sufficiently sophisticated to value the 'whole of life cycle' consequences of the GridX proposal. That is, they are unlikely to fully take into account the implications of GridX's proposal in terms of its replacement and maintenance cycles and how that translates to price. That valuation will be further complicated by GridX's monopoly not only on electricity services but also gas and hot water.
- (c) The AER notes in its Issues Paper that '*if GridX were to own the gas distribution network serving each estate/cluster of dwellings*' any person could seek coverage under the *National Third Party Access Code for Natural Gas Pipeline Systems 1997 (Gas Code)*. However it seems unlikely that such a small network would fulfil the requirements for coverage by the Gas Code², or alternatively (should the Gas Code not apply) that each such facility would be of 'national significance' for the purposes of a declaration application under section 44G of the *Trade Practices Act*. Even to attempt to use such a mechanism would present a very substantial barrier to competition for a small or medium sized customer and it is therefore unlikely that GridX would be competitively constrained by actual or potential access to its gas distribution network. The point at which such competitive pressure is most likely to be an effective constraint would therefore be maintaining a basis for third party access to its electricity distribution network.
- (d) GridX customers will not be subject to the same supply reliability and quality protections as other customers. This is a particularly important matter given the 'islanded' nature of the proposed network configuration, the absence of network redundancy and uncertainty surrounding maintenance arrangements in the event of a fault. As a consequence customers in the exempt estate may be receiving levels of supply reliability and quality that vary significantly from those provided by regulated network providers who are subject to a variety of codes and guidelines with respect to reliability and quality.
- (e) The GridX application states it will be required to maintain technical standards under its connection agreement with the local network service provider as part of its obligations as a market generator under the NERs. These obligations however relate to network connection hence do not afford any protection to individual customers connected to the GridX network.

² Particularly clause 1.19 Gas Code requiring that the request for coverage would promote competition in a market other than the market for the services provided by the pipeline.

Finally, registration requires that the participant has the necessary commercial and technical resources to enable them to satisfy the on-going needs of customers. Were an exemption granted, no such assessment of resources would occur. This is of particular concern in the case of a general exemption where it is unclear how many customers GridX may have.

Is it appropriate to grant GridX a general exemption from the requirement to register as an NSP, or is it appropriate to grant GridX an exemption on a project by project basis only?

GridX has sought through its application a general exemption. That is, if the exemption was to be granted, GridX would not be required to seek further exemptions each time its network solution is employed. Such an exemption has the potential to be applied very widely and ignores the various location or jurisdictional issues that may arise.

For example, GridX's application states a number of intentions with respect to arrangements in New South Wales however there are no similar statements made for other jurisdictions. Network and retail charges in some jurisdictions are based on cross subsidises between different energy users. Consideration of these issues needs to be conducted on a jurisdiction by jurisdiction basis.

GridX has also stated its solution will be employed in 'greenfield' locations where the local network is constrained. Should a general exemption be granted, GridX would not be required to demonstrate that future expansions of its network involve situations where the network is constrained or that the location is 'greenfield' in nature. GridX may therefore construct a network in parallel to an existing regulated network to 'cherry pick' customers potentially stranding existing network assets.

As noted in the Issues Paper, the AER's consideration of the GridX exemption is limited to consideration of the proposals advanced by GridX in its application. However, it maybe GridX develops alternate network configurations that may give rise to different considerations. Granting of a general exemption would not require GridX to seek a further exemption from the AER for alternate network configurations.

What (if any) are the nature of the conditions on exemptions that the AER should apply in respect to retail pricing?

CitiPower and Powercor believe that the AER should not issue an exemption to GridX which is not subject to the same regulatory obligations that apply to other network service providers/retailers. Customers who purchase a property in GridX development should be afforded the same protections offered to other residential electricity customers and perhaps more so, given they will be unable to access the commercial disciplines afforded through full retail competition.

If you wish to discuss further the matters raised by CitiPower and Powercor in this submission, please do not hesitate to contact me on (03) 9683 4509.

Yours sincerely

[signed]

Richard Gross
GENERAL MANAGER REGULATION