25 August 2016

Mr Chris Pattas
General Manager – Network Investment and Pricing
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3000

Dear Mr Pattas

RE: RING-FENCING WAIVER APPLICATIONS

Origin Energy (Origin) appreciates the opportunity to provide input to the Australian Energy Regulator's (AER) assessment of applications for ring-fencing waiver submitted by a number of distribution network businesses (DNSP) under clause 5.2 of the Electricity Ring-fencing Guideline.

Origin notes that running in parallel with the assessment of these waiver applications is a review of the Ring-fencing Guideline. We understand that the amended Guideline will not be finalised until after the closing date for submissions on the waiver applications. While we recognise that the changes under consideration are intended to improve the operability of the Guideline, as a matter of good governance we believe that assessments should not be made under a Guideline that is subject to change.

We are also concerned at the limited time that has been made available for stakeholders to provide comments, given the quantity of applications and the importance of ring-fencing.

The Guideline clearly sets out the requirements on the part of a DNSP with respect to the content of a waiver application and the matters that the AER must have regard to when assessing this application. Key among these criteria are the requirement for DNSPs to detail the costs associated with complying with the obligation if the waiver were refused. Equally, the AER must have regard to whether the benefit, or likely benefit, of the DNSP complying with the obligation would be outweighed by the cost to the DNSP of complying with that obligation.

The DNSPs highlight that to impose functional separation during a regulatory control period is a fundamental change to an existing determination. Origin recognises that regulatory certainty is a desirable attribute of any regulatory framework. Notwithstanding, every effort should be made by the DNSP to meet the information requirements of an application for waiver despite this fact. In this regard, we do not believe that any of the current applications has provided sufficient cost information to demonstrate that any change would be unreasonable. The onus must be on the DNSP to provide evidence of costs, not merely assert these exist.

For these reasons, we strongly encourage the AER to require the DNSPs to meet their information obligations under clause 5.2 of the Guideline rather than assert that costs exist.

Origin's comments on specific applications is provided below.

Ergon Energy

<u>Novation of Contracts</u>

As required by the Guideline, Ergon will cease the provision of Other Distribution services and these activities will be undertaken in future by Energy Impact. However, given lead times and preconditions for the novation of contracts, Ergon Energy states that it is unlikely to be able to effectively transfer

Origin Energy Electricity Limited ABN 33 071 052 287 • Level 45, Australia Square, 264-278 George Street, Sydney NSW 2000
GPO Box 5376, Sydney NSW 2001 • Telephone 02 8345 5000 • Facsimile (02) 9252 9244 • www.originenergy.com.au

these activities to Energy Impact by 1 January 2018. For this reason, it has sought a short term waiver of 6 months, and possibly even further subject to contract renegotiations.

Ergon Energy notes that the novation of contracts is dependent on the finalisation of the Energy Queensland Limited Group corporate structure, which is yet to receive Board and shareholder approval as well as changes to Energy Impact's service offerings and constitution.

Origin recognises that Ergon is currently in the process of a significant corporate restructure. Nevertheless, we believe compliance with the Guideline is a very important obligation and sends a strong signal that the regulatory framework is serious about supporting and promoting competitive markets. Networks are free to determine their corporate structure and how they operate their business subject to the conditions of the regulatory framework. Such decisions, irrespective of how difficult they make compliance for the business must not obfuscate the legitimacy of regulatory compliance. To the extent that Ergon has not finalised its structure, constitutions or service offerings is a matter for Ergon and its shareholders; these decisions were made independent of the requirements of the regulatory framework. Compliance should not be at the convenience of a business but should be applied consistently regardless of whether a business is embarking on structural efficiencies or mergers; in this regard waivers from regulatory compliance should only be granted in extenuating circumstances which we believe Ergon has not demonstrated.

For this reason, in the absence of the presentation of the contracts in question and the project plan governing this transition, which we would expect would have been in place quite soon after the publication of AER's Guideline in November 2016, we do not support the granting of a waiver with respect to novation of contracts.

Ergon Energy Branding

Ergon Retail (EEQ) provides retail services to non-market customers within the Ergon Energy distribution network. EEQ and Ergon Energy currently share the Ergon Energy brand. However, as Ergon Energy notes, to be compliant with the Guideline, one of the businesses would not be able to continue to use the Ergon Energy brand. Ergon advises that preliminary estimates of at least $7M to undertake a rebranding exercise for EEQ.

Ergon points out that EEQ is a non-competing retailer servicing non-market customers. The inability to offer market contracts means that EEQ's customers may only be supplied on the terms and conditions of the standard retail contract under the National Energy Retail Rules.

Ergon has proposed that the trigger for the waiver ceasing should be changes to the legislative framework in Queensland to remove EEQ's inability to offer market contracts to all market customers in Queensland.

Ergon Energy is not seeking a waiver from legal or functional separation (staff and office sharing), which will be implemented by 1 January 2018, and so there is limited opportunity for the business to discriminate in favour of EEQ under this waiver.

We accept that granting a waiver to allow EEQ to continue to operate under its current brand will not have an impact on competition for retail contracts because EEQ is a non-competing retailer and cannot actively compete for new customers. However, we note that a number of firms do compete for the provision of storage services including batteries, solar and solar power purchase agreement (PPAs) in the Ergon distribution network.

For these reasons, we seek assurances from the AER that any waiver with respect to the use of branding only applies to the provision of retail services under a standard retail contract. We believe the provision of any contestable services under the Ergon Energy branding is contrary to the Guideline and compromises the ability of market participants for these services to compete on a level playing field.

Regional Offices

Ergon Energy is seeking a waiver to allow the offices within the Mareeba and Charters Towers depot boundaries to be classified as regional offices for the purposes of the Guideline. Notably, this would allow staff at these depots to undertake both direct control services and contestable services without the need for separate branding.

Ergon Energy considers that the rationale for allowing a regional exemption exists because if Ergon Energy did not provide the contestable services, then there would be little or no other entities able to service customers in the region. Ergon Energy also notes that it is effectively the 'supplier of last resort' for some customers within these depot boundaries and as such cannot simply cease providing these services in order to more cost-effectively achieve compliance. It states that if these contestable services were not provided by Ergon Energy, it is likely that some customers could not obtain the service elsewhere, or for a reasonable price.

Origin agrees in part with the points. However, Origin through a related business does provide certain contestable services in these regions as far west as Campaspe, Pentland and Ravenswood; and from Mareeba as far as Atherton, Yungaburra and Babinda.

Notwithstanding, we acknowledge that there are likely to be certain contestable services where there are no viable providers other than Ergon. For this reason, we believe the waiver needs to be conditional on certain activities. As a suggestion, we believe that a conditional waiver could apply to contestable services in front of and including the customer's connection point, or, subject to the presence of competition, the metering point.

We also note that such waivers are not fixed and should circumstances change, Ergon or another stakeholder could seek to have the waiver amended to reflect changes in the operating environment.

Branding for CES

Ergon Energy is seeking a waiver from the obligation to have separate branding for staff performing unclassified and other distribution services from 1 January 2018 until 30 June 2025.

Ergon Energy argues that in addition to the contractual issues that influence the speed with which it can implement new branding, there are also operational constraints, which cannot be overcome by assigning additional resources. For example, it states that there will be a minimum manufacturing time, over which Ergon Energy has limited control. Ergon states that it will commence the transition once it has new procurement arrangements in place, following the expiry of existing contracts.

Origin considers that the performance requirements of uniforms and equipment is already well understood. We also note that its affiliate businesses such as Energy Impact and Metering Dynamics have been well established for many years with logos, marketing and in some instances uniforms already established.

We question whether existing contracts could be adjusted to capture changes in branding without material cost impositions. We would expect that once provided with new colours and logos new productions runs could be established without material increases in costs. Furthermore, we note much of the equipment in question has a relatively short economic life and well within the proposed transition period of eight years.

We also note that other DNSPs have not sought waivers to transition to new branding anywhere near the length of time sought by Ergon. For these reasons, we believe there is insufficient evidence to support a waiver of the duration sought by Ergon Energy. We believe that any waiver should be restricted to the end of this regulatory period.

Energex

Origin's comments on Energex's application for the novation of contracts and branding are the same as those provided on the Ergon application.

SAPN

We recognise that many services that SAPN seek a waiver for are services classified as part of the existing determination. Notwithstanding, as we stated in our opening comments, the onus must be on the network to provide sufficient evidence to allow the AER to make an objective decision regarding the cost verses benefit of compliance. This evidence cannot be asserted.

SAPN also state that not imposing functional separation for these services will not in any way advantage any SAPN affiliate, as they will be performed by SAPN. We believe that the more relevant point is whether having these services performed by SAPN or an entity carrying the SAPN brand disadvantages competing firms for these services. It is not about whether SAPN affiliates are advantaged or disadvantaged, it is the impact on the market for these services that is more relevant.

We note that SAPN has highlighted that in certain instances it is more practicable for SAPN to undertake both distribution and contestable services. We assume SAPN is referring to instances similar to those detailed in the Ergon submission where the network is often the provider of last resort.

To enable an informed decision to be made, SAPN should be required to specify where, why and for what services it considers these circumstances exist, much the same way Ergon has. In the absence of this specific information, we would be very concerned if the AER were to extend what would effectively be a blanket waiver.

Closing

We accept that there are a number of services subject to waiver application that may be uncontentious. Equally, there are others that do have greater implications for creating a level playing field for contestable services. Irrespective of the service in question, an application for waiver must meet the information requirements set out in the Guideline.

As the first applications for waiver under the AER's revised Guideline, we believe that it is essential that the AER set a strong precedence around the obligations on a DNSP regarding the content of an application and also the manner in which the AER undertakes its assessment.

Given the importance of ring-fencing, it is incumbent on the AER to establish a strong compliance framework to send a strong signal that the regulatory framework will support an environment where competitive and potentially competitive markets are not compromised by the participation of a regulated monopoly.

If you have any questions regarding this submission please contact Sean Greenup in the first instance on (07) 3867 0620.

Yours sincerely

Keith Robertson
Manager, Wholesale and Retail Regulatory Policy
(02) 9503 5674 keith.robertson@originenergy.com.au