



24 February 2012

Mr Chris Pattas
General Manager, Network Operations and Development
Australian Energy Regulator
GPO Box 520
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By e-mail: AERinquiry@aer.gov.au

Electricity Distribution Ring-Fencing Guidelines Review - Discussion Paper

Dear Mr Pattas

Origin Energy Retail Limited (Origin) welcomes this opportunity to respond to the Australian Energy Regulator's (AER's) discussion paper on ring-fencing guidelines for electricity distribution businesses.

Origin agrees with the AER's view on page 4 of the discussion paper that ring-fencing guidelines help preserve competition in upstream and downstream markets and are an important tool in maintaining the benefits of energy sector reform.

In our view, oversight supporting ring-fencing is as necessary today as it was when vertical separation of distribution and retail businesses first took place, if not more. This view is based on:

- The emergence of new products, for example cost effective smart meter and home area network technologies that have the potential to blur the distinction between natural monopoly and competitive spheres of the Electricity Supply Industry (ESI);
- The need to develop national ring-fencing guidelines as enforceable instruments to eliminate the inconsistencies that exist today;
- The national focus of many retail market participants and the general efficiencies gained from harmonisation across jurisdictions in which retailers are active; and
- The need to review existing guidelines, which have remained unchanged for more than ten years in some cases despite significant change in industry structure and maturation of the retail electricity market over this time.

Therefore, Origin strongly supports a review of current jurisdictional arrangements and the development of a draft Distribution Ring-Fencing Guidelines for stakeholder review.

Origin also supports the submission prepared by the Energy Retailers Association of Australia, particularly with respect to its discussion of market power issues, competitive neutrality and the context provided in relation to the separation of contestable and monopolistic elements of the ESI.

Our comments on specific matters raised in the AER's issues paper are set out below.



Should you have any questions or comments on this response, please do not hesitate to contact me in the first instance.

Yours sincerely

[SIGNED]

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Response to specific questions raised in the discussion paper

1. *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?*

Origin believes that ring-fencing is an appropriate means of addressing issues of vertical integration of DNSPs and remains a relevant tool for managing vertical integration risks. However, new technologies (such as smart meters) require that the scope of current ring-fencing arrangements be reviewed. Such technologies have decreased in cost and have become more sophisticated, allowing significant opportunity to provide new services previously unavailable to end use customers.

It is Origin's view that competition among retailers and third parties will lead to the best outcomes for consumers. The DNSP's function in this environment is to provide open-access for competitors, rather than compete itself. To the extent a DNSP wishes to engage in the provision of such services to end-users, they should do so outside of their regulated business, appropriately ring-fenced and ideally through a structurally separated entity.

2. *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?*

Origin considers that a national set of ring-fencing guidelines for DNSPs is desirable. The current provisions of the Competition and Consumer Act are not sufficient to deal with the special challenges that vertical integration presents in the energy sector; particularly in relation to smart meter technology and related goods and services. We believe the special circumstances of the ESI warrant specific ring-fencing provisions that may not be required in other industries.

3. *Are the current enforcement mechanisms sufficient to ensure effective compliance by DNSPs with their ring-fencing obligations?*

Origin is aware of waivers granted under current ring-fencing instruments, but within the ESI, is unable to judge the effectiveness of existing enforcement mechanisms. Enforcement of any national DNSP ring-fencing guideline should be made consistent where appropriate with the National Energy Consumer Framework (NECF) enforcement provisions. Historically, ring-fencing enforcement and regulation has been light-handed in nature (at the jurisdictional level). Under the NECF, this is likely to change if ring-fencing is incorporated into national regulation.

4. *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?*



Existing jurisdictional guidelines are no longer appropriate and this is primarily not a function of changes to industry structure. Despite the fact that privatisation of state-owned business has left few DNSPs with a related retail business with common ownership (exceptions: Aurora and Ergon), this does not weaken the case for continued regulation. It is rather the opposite since:

- Regulated DNSPs may have incentives to pursue opportunities in competitive markets, for example, markets for services enabled by smart meters.
- Emerging markets (electric vehicles, energy storage, smart metering and home area networks) often integrate into the DNSP's own network, providing them with a level of access and insight that downstream competitors may not enjoy.

5. *Are there matters that the Transmission Ring-Fencing Guidelines deal with that a national set of Distribution Ring-Fencing Guidelines should not?*

In principle, it is not clear why the Distribution Ring-Fencing Guidelines should not be consistent with the Transmission Ring-Fencing Guidelines. There are potentially more opportunities for DNSPs to engage in competitive downstream markets than are available to TNSPs. As such, ring-fencing requirements should not be any weaker than those applied to the transmission sector.

6. *What matters should distribution ring-fencing guidelines address and what is the appropriate way to deal with such matters?*

Headings 4.2.1 - 4.2.5 of the discussion paper describe areas that a national guideline should contain.

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

On page 16 of the discussion paper the AER sets out some of the issues in relation to physical separation of related businesses from the DNSP's core business:

...physical separation of staff that provide specified services in a contestable area, from those that provide services in the distribution area, or that marketing staff involved in the distribution business are not involved in any other business...

We note that while a new market, home area network services (enabled under the mandatory Victorian Advanced Metering Infrastructure roll out) may be developed without reference to the obligations described under section 4.2.5 of the discussion paper. New load control and network management benefits may be created in this emerging market (and captured by DNSPs), however it is also competitive in nature and is an example of why current regulation may not adequately address the objectives of ring-fencing the activities of DNSPs.



Generally, the existing jurisdictional guidelines do not sufficiently define the boundary between what is contestable and what is not. Given such uncertainty, market participants and stakeholders may lack confidence in the effectiveness of competition within such markets, or be reluctant to participate in them. Any review of existing guidelines would provide some overdue dialogue on such issues. Clarity and national consistency will greatly enhance existing provisions.

8. Should the AER work to develop a set of national guidelines?

Origin believes that a national set of consistent guidelines be developed with some priority. The Victorian guidelines should be revoked when a national ring-fencing regime is developed.

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

The current structure of the NEM does not mean that ring-fencing for DNSPs are no longer required. Ownership changes (between related distribution and retail entities) may have altered some of the historic basis for the introduction of ring-fencing, but absent the prohibition of DNSPs participating in competitive markets (that may be potentially funded through regulated revenues recovered from all of their customers); a significant role for ring-fencing oversight remains.

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

Given the emergence of new products and services, and the key role DNSPs often play in the provision of infrastructure supporting these services, ring-fencing guidelines need to provide clarity on how, when and under what conditions it is appropriate for owners of monopoly infrastructure to participate in these new markets. The guidelines should preserve competitive neutrality in such circumstances and this should be a key objective of a nationally consistent set of ring-fencing guidelines.

11. 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?

Certain limits should apply for DNSPs generating electricity to offset energy consumption (auxiliary power consumption for certain network assets, buildings and depots etcetera). As for many demand-side management activities, such generation could be provided to the DNSP by third parties, responding to competitive tender. The materiality of the activity should be the key test to determine whether activities are in keeping with ring-fencing principles.



12. 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?

A review of existing ring-fencing guidelines would build confidence in their effectiveness and may encourage industry stakeholders to participate in markets that are contestable now or are emerging and will benefit from competition in the future. The existing arrangements feature inconsistent levels of coverage across jurisdictions and may not effectively deal with emerging market issues and technological advancement in the ESI.

Greater clarity of how DNSPs can participate in downstream (or upstream) markets will encourage increased participation and innovation from non-DNSP service providers.