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13 November 2017

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

Submitted via email to: ringfencing@aer.gov.au

Dear Mr Pattas,

Re: AER Ring fencing waiver applications: Draft Decision

Summary

Red Energy (Red) and Lumo Energy (Lumo) welcome the opportunity to respond to the Australian Energy Regulator's (AER) Draft Decision DNSP applications for waivers from the Electricity Distribution Ring-fencing Guideline (the draft decision).

The AER has issued this draft decision following the multiple Distribution Network Service Provider (DNSP) waiver applications it received under clauses 3.1, 4.2 and 4.4.1(a) of the Electricity Distribution Ring-Fencing Guideline (the Guideline).

It is crucial for the AER to apply a strict interpretation of the Guideline and its application to the National Electricity Rules (NER). By doing this, it will set a strong decision making precedent and demonstrate that the AER takes Guideline compliance seriously.

Red and Lumo are concerned that the relaxed approach to applying the Guideline, which the AER appears to have applied by granting many of the waivers will not be in the long term interests of consumers. It will be detrimental to competition in the market for contestable energy services in the long term and it will raise serious questions on the effectiveness of the Guideline.

The AER has bundled the DNSP waiver applications into six categories, below is a summary, followed by a more detailed discussion of our positions.

Reclassification of services

Red and Lumo strongly oppose the waiver application for the premature reclassification of negotiated and unclassified services to alternative control services. These should be assessed in the framework and approach process. Making regulatory decisions in the appropriately defined processes will ensure that future decisions are not prejudiced by current assumptions, rules and technological constraints.

Legal and functional separation

We strongly object to the legal and functional separation waivers. Compliance with the NER and Guideline has been known since November 2016, allowing ample time for DNSPs to move their contestable services to a suitable ring-fenced affiliate.

Branding

We object to the branding waivers that allow a DNSP to continue to market its products by using its brand in a contestable energy market. It is likely to prejudice the competitiveness of the market for contestable energy services, as it will utilise existing brand awareness and customer loyalty which has been established using regulated revenue.

Regional service delivery

Following the recent Queensland Government announcement that it will remove the prohibition of reversion and further open up the Ergon distribution area to more competition, Red and Lumo are concerned with the AER's decision to grant a waiver in Ergon's distribution area for branding separation from its Ergon Energy retail brand. Ergon must separate its regulated, distribution services from its contestable, retail services.

Gas businesses

Red and Lumo are comfortable with the AER's decision to grant legal and functional waivers to ActewAGL gas pipeline businesses. However, we do not support the AER's decision to grant ActewAGL a short term waiver from functional and legal separation of the contestable compressed natural gas (CNG) Refuelling Facility. Under these arrangements, the two gas pipeline businesses could potentially cross subsidise the CNG refuelling facility.

Regional offices

The AER must assess whether the potential for competition exists, and ensure that granting a waiver does not create a self-fulfilling prophecy which drives out competition. This is particularly important for the AER to review with the introduction of competition in metering and related services (including customer connection services in NSW) and the AEMC's current deliberations in the competition in energy services rule change.

Waiver 1 - Reclassification of services

Red and Lumo strongly oppose these waiver applications under the Guideline.

DNSPs have applied for waivers for services they consider are likely to be reclassified at the next determination to bridge the compliance deadline of 1 January 2018 and the commencement of their next regulatory control period.

The draft decision outlines that moving of these unclassified services to a ring-fenced affiliate, and (where applicable) the branding and relocation costs would provide net benefits. Furthermore, the AER has permitted these waiver applications because the current view is the negotiated and unclassified services offered by the DNSPs will be reclassified as ACS at their next rate review.

The AER must be firm on the NER and its application of the Guideline when making a decision on these waiver applications. The AER's decision to pre-empt a future regulatory determination (by assuming some negotiated and unclassified services will be reclassified as ACS at the next rate review) sets a dangerous precedent. A prudent regulator should make decisions and review these services in the appropriately defined process (e.g. the Framework and Approach) to ensure that future decisions are not prejudiced by current assumptions, rules and technological constraints.

Waiver 2 - Legal and functional separation

Ausgrid, Endeavour Energy, Ergon Energy, Energex and TasNetworks - 6 month transitional waivers
Red and Lumo do not support these waiver applications under the Guideline.

These DNSPs have not complied with the Guideline in time, due to their own inefficiencies. The NER was amended in November 2016, and these DNSPs knew that they needed to comply with the Guideline to move their contestable services to an appropriately ring-fenced affiliate. As evidenced by the DNSPs that have complied, as of 1 January 2018, they would have had 14 months to undertake this work. This is more than a reasonable timeframe to implement a change of this magnitude.

TasNetworks - contestable meters (Type 1-4)

Red and Lumo do not support the TasNetworks waiver application under the Guideline.

The AER suggests the costs that may be incurred should the retailers be forced to accept responsibility for the meters sooner than they have otherwise planned are significant. However, the AER has failed to provide any direct evidence to quantify the costs against the benefits of this decision. Absent of this, we are unable to support the waiver.

Waiver 3 - Branding

CitiPower and Powercor - Powercor Network Services, CitiPower and Powercor brands
Red and Lumo do not support this waiver application under the Guideline.

Section 4.2.3(a)(i) of the Guideline makes it clear that a DNSP needs to use separate branding for its direct control services from the other services it provides from a related electricity service provider, otherwise known as its ring-fenced affiliate. Powercor Network Services is clearly a related electricity service provider and its intended use of the Powercor brand is in direct violation of section 4.2.3(a)(i) of the Guideline.

We welcome the AER's draft decision that CitiPower and Powercor must restrict their brand in tendering for new contracts, and that they must not use their brand to provide services to residential customers. We are concerned with the AER's disregard for the importance of commercial and industrial customers (C&I) in this market.

Powercor Network Services has been active in this market for some time. This is likely to have resulted in significant brand awareness and customer loyalty. Similarly, the use of Citipower branding when performing non-direct control services for C&I customers is likely to unfairly prejudice this market in the near term.

We do not consider granting these waivers to be in the long term interests of consumers. Other network businesses have faced similar branding issues, with no waivers required. We do not consider Citipower and Powercor should be rewarded for their disorganisation.

Energex and Ergon Energy - other electricity services and unclassified distribution services
Red and Lumo do not support this waiver application under the Guideline.

Energex and Ergon are requesting branding and cross-promotional waivers to allow them to continue to use Energex and Ergon branding on uniforms and fleet used in the provision of contestable energy services, is in direct contravention of section 4.2.3(a)(i) of the Guideline. As noted above, the Queensland Government has intentions to further contestability in the regional Queensland area, which should be taken into account by the AER when making their final decision.

Rebranding can be done with ease, and does not require uniform trials and significant costs. Other DNSPs have managed to comply with these obligations, as such we do not support the waiver being provided to Energex and Ergon. The AER should make enquiries to Energex and Ergon to ensure that they have taken their new obligations seriously, and have used the 14 month lead time for compliance to develop new uniforms and branding and not repurchase regulated-branded stock.

Waiver 4 - Regional service delivery

Red and Lumo note the AER's decision to provide a group of waivers in the regional area serviced by Ergon.

Red and Lumo are disappointed by the draft decision. In our view, even though the AER has granted these waivers to regulated monopolies, by doing so it can create a self-fulfilling prophecy and greatly reduce the potential for effective competition developing in the contestable areas of these markets. Ergon and Essential Energy's CAM will reduce the risk of any cross subsidisation. However, the sole reliance on a CAM to reduce the risk of cross subsidisation is fraught with danger. Legal and functional separation represents a much better and more compliant mechanism to reduce the risk of cross subsidy.

We support the AER's draft decision that Ergon's waiver excludes behind the meter services. As noted above, the Queensland Government has intentions to further contestability in the regional Queensland area, which should be taken into account by the AER when making their final decision.

Waiver 5 - ActewAGL gas businesses

Red and Lumo are comfortable with the waiver for legal and functional separation relating to ActewAGL Distribution (AAD) covered and uncovered pipelines. Nevertheless, we do not support the AER's draft decision to support a short term waiver to AAD for it to continue to own and operate its unregulated CNG refuelling facility.

The CNG refuelling facility is a contestable and unregulated business. As such, under the Guideline it should be located in a suitably ring-fenced affiliate. Furthermore, AAD argues the CNG refuelling facility is unprofitable and potentially loss making. It suggests if the waiver is not granted it may choose to close the refuelling business.

If the AER grants a waiver for functional and legal separation for these three gas business, it may provide AAD with the potential to cross subsidise its loss making CNG refuelling facility through its pipeline businesses. This is a concern especially because AAD claims the CNG refuelling facility is running at a loss. Regulated revenue should not be cross-subsidising an unprofitable, contestable business.

The AER's decision to restrict the waiver for the CNG Refuelling Facility until 30 June 2019 is a step in the right direction. In addition, absent a decision by the AER to legally separate the CNG refuelling facility, requiring AAD to produce a revised CAM may satisfy concerns regarding the cross-subsidisation the CNG refuelling facility; but, it does not go far enough.

Waiver 6 - Regional Offices

The AER must be satisfied that there is no or very limited competition prior to granting a waiver for regional offices for Essential and Ergon.

The Guideline includes regional office exemption clauses to address this characteristic, typically found in rural and regional areas. Regional office waivers are granted where a DNSP would be permitted to share an office with one of its ring-fenced affiliates. Commercial opportunities can arise as potential flows of information between the DNSP and its ring-fenced affiliate at the disadvantage of competitors by virtue of sharing an office space.

Red and Lumo remain advocates of competitive markets and market outcomes over regulated solutions. Therefore, it is important for the AER to determine whether there is any competition or the potential for a market to develop prior to making any decision to grant a waiver. This is particularly important for the AER to review with the introduction of competition in metering and related services (including customer connection services in NSW) and the AEMC's current deliberations in the competition in energy services rule change.

About Red and Lumo

Red and Lumo are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales and South Australia and electricity in Queensland to over 1 million customers.

Should you have any further enquiries regarding this submission, please call Con Noutso, Regulatory Manager on 0481 013 988.

Yours sincerely

A handwritten signature in black ink, appearing to read "Ramy Soussou". The signature is stylized with loops and a long horizontal stroke at the end.

Ramy Soussou

General Manager Regulatory Affairs & Stakeholder Relations
Red Energy Pty Ltd
Lumo Energy Australia Pty Ltd