16 March 2018

Mr Chris Pattas
General Manager, Networks
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Mr Pattas

Service classification and asset exemption issues paper submission

CitiPower, Powercor and United Energy welcome the opportunity to comment on the Australian Energy Regulator's (**AER**) Service classification and asset exemption guidelines Issues paper. In summary:

- The AER should not restrict distributors' entry into markets without having demonstrated existing competition law is inadequate to protect competition. Unnecessary restrictions can only result in a loss of innovation and efficiency ultimately to the detriment of consumers.
- We support the AER's current service classification approach of adopting service groupings and applying an incremental approach to reviewing service classification.
- We support the development of broad criteria for determining whether an exemption to 'behind the connection point' restrictions will be granted to accommodate fast changing market conditions.

These issues are discussed further below.

We welcome the opportunity to discuss this letter with the AER. Please contact Frans Jungerth on 03 9683 2022 or fjungerth@powercor.com.au if you have any questions.

Yours Sincerely

Brent Cleeve
Head of Regulation
CitiPower, Powercor & United Energy

1 Service classification

We support the AER's current service classification approach and believe the guideline should clarify and formalise, rather than change the process. Below we provide comments on some specific areas of the AER's issues paper.

1.1 Promoting distributor competition

The AER is considering:

- Providing guidance on what constitutes a distribution service, including considering whether services such as voltage regulation are distribution services.[1]
- Providing a fuller list of unclassified services.[2]

When taken together with the ring fencing guideline, which places restrictions on providing non-distribution and non-direct control services, this indicates the AER is considering whether distributors should be restricted from operating in competitive markets. We do not consider it good for the competitive process or achieving the National Electricity Objective (**NEO**) to restrict distributors from providing certain services in order to protect other competitors.[3]

Limiting regulatory intervention to promote competition

Consistent with the fundamental principle of competition policy, targeted regulations on distributors should be imposed only if there is sound evidence their activities would harm the competitive process and the benefits of the regulation outweigh the costs.[4] In making this assessment, existing protections, such as competition law prohibitions under Part IV of the *Competition and* Consumer *Act 2010* (Cth) (**CCA**), need to be considered. The Australian Government Guide to Regulation provides that:[5]

> *Policy makers should be aware of existing regulations or mechanisms to deal with perceived or actual market failures, monopolies and abuse of market power. The Competition and Consumer Act 2010 provides a range of powers that may well address the problem and make further regulation unnecessary or counterproductive.*
>
> *Policy makers should look to existing regulations and their actual or potential application before proposing new regulation.*

Relevant provisions in the CCA that protect competition include:

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1 AER, Issues paper, Service classification and asset exemption guidelines, February 2018, p. 16.

2 AER, Issues paper, Service classification and asset exemption guidelines, February 2018, p. 18.

3 As the recent Harper Competition Policy Review noted, '[a]focus on the competitive process, rather than individual competitors, and the interests of consumers is a well-established principle of competition policy across the globe' and competition policy 'is not designed to support a particular number of participants in a market or to protect individual competitors; instead, it is designed to prevent competitors' behaviour from damaging the competitive process to the detriment of consumers': Competition Policy Review, Final Report, May 2015, p. 23 & 307.

4 The Hilmer Report included the principle '[p]roposals for new regulation that has the potential to restrict competition should include evidence that the competitive effects of the regulation have been considered, that the benefits of the proposed restriction outweigh the likely costs, and that the restriction is no more restrictive than necessary in the public interest': Hilmer, Rayner and Taperell *National Competition Policy*, 1993, page 207. This is reflected in COAG's Best Practice Regulation Guide, which notes 'restrictions on competition should be avoided or minimised' and that regulation 'should only restrict competition where this is necessary to achieve the objective, and the benefits of restricting competition outweigh the costs': Council of Australian Government, Best Practice Regulation: A guide for Ministerial Councils and National Standard Setting Bodies, October 2007, p. 5.

5 Australian Government Guide to Regulation 2014, p. 23.

- Section 46, which prohibits corporations that have a substantial degree of market power from engaging in conduct that has the purpose, effect or likely effect of substantially lessening competition in a market.
- Exclusive dealing conduct and other arrangements are prohibited if they substantially lessen competition.

These already ensure market power is not misused and recognise market power is not in itself harmful to the competitive process. For example, the Australian Competition and Consumer Commission (**ACCC**) noted in its Interim Guidelines on misuse of market power that Section 46:[6]

> *[does not] prohibit a firm with a substantial degree of market power from 'out-competing' its rivals by using superior skills and efficiency to win customers at the expense of firms that are less skillful or less efficient. This conduct is part of the competitive process, which drives firms to develop and offer products that are more attractive to customers, and should not be deterred.*

Targeted regulations (beyond the Part IV prohibitions) that change the rights of infrastructure businesses have to date only addressed the need to provide access to the services provided by the infrastructure. It is well accepted that the competition protections of Part IV of the CCA do not suffice to address this 'access problem' or 'essential facility problem'.[7] However, regulations that potentially restrict distributors from competitive markets (through service classifications and the ring fencing guideline), go well beyond what is required to address this 'access problem'.

The AER should not seek to restrict distributors from markets without demonstrating existing competition law is inadequate to protect competition. A high bar has been set on implementing additional regulations because unnecessary restrictions could be detrimental to competition by restricting the ability of distributors to use their skills and efficiency to innovate and facilitate the growth of new markets for the benefit of all consumers.

Participation in the Reliability and Emergency Reserve Trader scheme

We have operated the network in a way to provide reserve energy on short notice for the Australian Energy Market Operator's (**AEMO**) Reliability and Emergency Reserve Trader (**RERT**) scheme. This helps enable AEMO to maintain power system reliability and system security.[1]

Our participation in this RERT market has not prevented others parties from also competing. Each party in this market may perhaps compete in different ways—for example, generators can increase their output and demand aggregators may have agreed with customers to curtail load. Nevertheless by each participant having its own (sometime unique) mechanism by which to offer RERT services, does not lessen competition. It simply means that through innovation each party has found its own way to compete.

Ring fencing and competition

It is not only the potential prohibition on participating in markets (via a combination of service classification and ring fencing) that may restrict competition. The ring fencing guideline in its own right is likely to have already provided more restrictions than needed to protect competition.

While some provisions of the ring fencing guideline—such as the requirements for separate accounts and cost allocation—can be readily reconciled with the competition policy rationale for targeted regulatory intervention (beyond the Part IV prohibitions), others cannot. Much of the conduct the guideline targets goes beyond this

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6 ACCC, Interim Guidelines on misuse of market power, October 2017, p. 4.

7 This is the very competition policy rationale that underpins the regime for access regulation of distribution networks established by the National Electricity Law and National Electricity Rules.

and would either be caught by existing competition law prohibitions or would not harm the competitive process. For example, section 46 of the CCA would prevent distributors from using joint branding or advertising if such conduct could have the likely effect of substantially lessening competition in a market. These requirements instead impose unwarranted costs on distributors and lessen competition.

We encourage the AER to:

- Carefully consider the way its service classification guideline and classification decisions will interact with the ring fencing guideline to ensure it doesn't restrict distributors' participation in markets and lessen competition.
- Over time, review whether existing restrictions may already be having the effect of reducing competition.

1.2 Guidance on distribution services

The AER has outlined the service classification guideline will provide guidance on what constitutes a distribution service.

We are concerned that attempting to provide clarity on the term 'distribution services' may instead lead to confusion. This term is used widely throughout the National Electricity Rules (**Rules**) and the AER's guidance may not be appropriate in all circumstances. Industry participants may then face a need to depart from the AER's service classification guideline or inappropriately change arrangements to suit the AER's guidance. Furthermore, as the Australian Energy Market Commission (**AEMC**) discussed in its *National Electricity Amendment (Alternatives to grid-supplied network services)* rule determination, the definition of this term is mirrored in the Law 'electricity network services' definition. This may again cause consistency problems.

Given that any clarity the AER provides will not be binding and may lead to confusion, we do not believe it would be helpful for the AER to seek to clarify the term.

1.3 Service groupings, harmonisation and classification stability

We support the AER's practice of classifying service groups as adopted in recent framework and approach decisions. To the extent service groups are consistent across jurisdictions, it will aid stakeholders to harmonise the grouping's name and classification. However, we do not support artificially 'forcing' services into having consistent terminology and classifications where market conditions differ. Services where market conditions differ between jurisdictions include metering, public lighting and connections.

We consider the AER's incremental approach to service classification is appropriate. Typically, it is clear for which services the market or regulatory conditions have changed. Furthermore, it is impracticable for the AER to assess each service against each form of regulation factor for every framework and approach paper it develops. Such detailed considerations would make it more difficult for stakeholders to understand and engage in the classification process.

We also consider it important for the service classification process, and in turn the guideline, to remain flexible to accommodate new services that will arise as markets evolve. We therefore consider the guideline should be principles based rather than seeking to define services or lock-in particular classifications.

2 Asset exemption

The asset exemption guideline will exempt distributors from the restrictions on owning behind the connection point assets in the circumstances described in the guideline. Our comments on this guideline are outlined below.

2.1 Asset exemption criteria

With markets changing more quickly, it is, and will continue to be, challenging to foresee behind the connection point services distributors may seek to provide. Therefore we suggest the AER's criteria for adding assets to the

Regulatory Asset Base (**RAB**) allow for broad discretion. In so doing, the AER will be able to assess the merits of each proposal without it having to depart from a restrictive guideline. We support the AER using the NEO or contribution to competition for energy related services as the criteria to determine whether an exemption is granted.

2.2 Scope of the guideline

We support the proposed scope of the exemption guideline outlined by the AER.[8] The AER may also consider outlining a process by which distributors who invest in behind the connection point assets within the regulatory control period (without an exemption), may seek the preliminary view of AER staff as to the likelihood of receiving an exemption and having the assets rolled into the RAB at the end of the period. This may reduce some of the uncertainty associated with the AER setting assessment criteria that affords it broad discretion.

2.3 Other issues

We disagree with the AER's statement that competition will be best promoted in the markets for energy related services if distributors do not compete in them.[9] If distributors compete, they increase the number and diversity of competitors, and competition. We acknowledge there maybe circumstances under which distributors could harm competition, such as providing cross subsidies, however, we trust the AER remains balanced in considering distributor participation as discussed above.

[8] AER, Issues paper, Service classification and asset exemption guidelines, February 2018, p. 23.

[9] AER, Issues paper, Service classification and asset exemption guidelines, February 2018, p. 24.