



Mr Chris Pattas
Australian Energy Regulator
Level 35, 360 Elizabeth Street
Melbourne VIC 3000

Lodged electronically to: Ringfencingguideline2016@aer.gov.au

Monday, 30 May 2016

Dear Mr Pattas,

RE: Electricity Ring Fencing Guidelines

ENGIE appreciates the opportunity to comment on the Australian Energy Regulator (AER) electricity ring fencing guideline preliminary position paper (position paper).

ENGIE is a global energy operator in the businesses of electricity, natural gas and energy services. ENGIE is the number one independent power producer in the world with 115.3 GW of installed power-production capacity, 19 GW of which is renewable. ENGIE employs 1,800 people in Australia and supplies 12 per cent of Australia's National Electricity Market, and has an installed generating capacity of more than 3,550 MW. ENGIE owns Simply Energy which provides electricity and gas to more than 550,000 customer accounts across Victoria, South Australia, New South Wales and Queensland.

This submission represents the views of ENGIE and by extension Simply Energy. To be clear, references to ENGIE in this submission should be understood to refer to both ENGIE and to Simply Energy.

As noted in the position paper, ring-fencing arrangements have up until now, largely been focused on separating regulated network services (poles and wires) from contestable services (retail and generation). Recent developments in the National Electricity Market (NEM) including advanced metering, connection and decentralised energy resources have made it clear that ring fencing needs to be applied more broadly to all contestable services.

In their final determination on metering contestability¹ the Australian Energy Market Commission (AEMC) placed an obligation on the AER to develop distribution ring-fencing guidelines for the accounting and functional separation of the provision of direct control services from other services provided by distribution network services providers

¹ AEMC, *National Electricity Amendment (Expanding competition in metering and related services) Rule 2015*, p. 78



(DNSPs). ENGIE believes that the AER position paper provides a valuable outline of the key considerations in establishing effective and efficient ring-fence boundaries, and that the proposed set of ring-fencing obligations provide a good basis for consideration and discussion.

ENGIE notes that in the position paper the AER makes the point that there is a justifiable case for regulated businesses being excluded from offering services that can be obtained in contestable markets, but that such structural separation of regulated from contestable business activities goes beyond the scope of ring-fencing under the National Electricity Rules.

ENGIE agrees that structural separation is likely to provide the most effective method to ensuring that regulated businesses do not detrimentally impact on competitive businesses. This conclusion is not surprising as it is consistent with the thinking that underpinned the establishment of the competitive NEM, where it was recognised that structural separation of regulated networks from retail and generation was important in achieving effective competition in the contestable sectors.

ENGIE encourages the AER not to dismiss structural separation as being outside of the scope of the consideration of ring-fencing guidelines.

Since the AEMC have now placed an obligation on the AER to develop ring-fencing guidelines, ENGIE suggests that it is appropriate for the AER to describe the most effective method of maintaining separation between regulated and contestable elements of the energy sector. If the AER finds that the most effective method is structural separation, and if this is found to require changes to the National Electricity Rules, then ENGIE believes that it would be important that the AER propose policy makers give consideration to progressing changes to the National Electricity Rules.

Notwithstanding that ENGIE believes that structural separation is likely to lead to more effective competition, we provide the following comments on the ring-fencing approach that the AER propose in the position paper.

The proposed approach that the AER have outlined is summarised below:

DNSPs that provide direct control (regulated) services must:

- 1) not carry on a ring-fenced service unless it is within a separate legal entity
- 2) not locate a ring-fenced service at the same physical location as the DNSP
- 3) not share staff between the ring-fenced entity and the DNSP
- 4) establish and maintain separate financial accounts
- 5) ensure there is no cross subsidy between the ring-fenced entity and the DNSP
- 6) ensure information provided by a customer is used only for the purpose for which that information was provided
- 7) ensure information provided to a ring-fenced entity is also available to third parties
- 8) ensure information obtained by the DNSP is not disclosed to any party without approval of the customer



ENGIE notes that the first five points in the AER proposal aim to achieve a proxy for structural separation between the regulated DNSP services and the contestable services. ENGIE would suggest that separation of IT systems and databases be included in the list since regulated networks could gain a significant advantage through the use of IT and data gained from its regulated network activities.

The last three elements in the above list seek to impose restrictions on the use and circulation of information obtained by a DNSP and its ring-fenced entity. ENGIE can envisage potential interpretation difficulties with item six which seeks to ensure that customer information is used only for the purpose for which it was provided. With the advances in metering data and the growing complexity of interactions between the electricity industry and consumers, it will be increasingly difficult in many instances to be clear and specific about the purpose for any given piece of information. For example, the daily usage profile of a customer would be valuable information for a wide range of purposes, and attempting to limit this to one particular purpose could be problematic and inefficient.

The three items relating to information aim to restrict the advantage that a DNSP has by virtue of its monopoly access to relevant information in its distribution area. Another method to prevent a DNSP exploiting its information monopoly advantage would be to restrict DNSPs to only being able to provide contestable services outside of its network area. Alternatively, DNSPs considering providing a contestable service might be required to make the service available to all customers, including those that are outside of its network area.

ENGIE believes that item 7 in the list should be strengthened to ensure that when a DNSP, through carrying out its regulated functions, collects information that has potential value to the contestable sector, then the DNSP should be required to make this information available to its competitors' subject to customer consent.

ENGIE also believes that in order to facilitate competition in the provision of distributed energy services, DNSPs will need to ensure that their activities do not provide an unfair advantage to their affiliated ring fenced entities. However, it is difficult to see how this could not be the case. The very desire for DNSP's to provide additional services almost exclusively within their geographic boundaries illustrates that seeking to leverage monopoly businesses positions is critical to the networks business case.

As such, it is expected that DNSP's will seek to identify opportunities for new services that could provide value to customers, and deliver those services through the competitive market but advantaged by their monopoly position. Attempting to guard against such outcomes will be particularly challenging and may ultimately only work to consolidate the networks dominant geographical position.

While the conditions identified by the AER might be a reasonable proxy to structural separation there remains a question as to just how effectively these elements can be implemented in practice, and how they might be monitored and enforced in a cost effective manner.

In addition to the preceding general comments, ENGIE has set out below responses to some of the specific questions posed in the position paper.



Question 1: What aspects of current jurisdictional ring-fencing arrangements have or have not worked well?

The current ring-fencing arrangements vary across jurisdictions, and are quite narrowly defined in many instances. The inconsistencies of approach across jurisdictions can make it difficult for businesses that are operating in multiple jurisdictions across the NEM. As a result, there have arguably been drivers in support of stronger, more uniform ring-fencing arrangements for some time now. These have been strengthened by relatively new drivers such as increased penetration of smart meters, solar PV and smart grids.

So although ring fencing arrangements have arguably been acceptable to date, ENGIE believes that they need to be substantially more robust and uniformly applied across the NEM to meet new challenges such as distributed energy resources and advanced metering.

Question 2: Do you consider the objectives discussed in section 2.1 adequately reflect the harm ring-fencing is seeking to avoid and the benefits of an even playing field?

The AER position paper suggest that the objectives of the ring-fencing guidelines are to:

- Avoid cross-subsidies that would adversely affect markets for contestable services or the efficient provision of regulated services;
- avoid discriminatory interactions between the contestable and non-contestable services;
- avoid providing a preferred or related party with an unfair advantage;
- promote an even playing field that encourages market entry

ENGIE agrees with the intent of these objectives, but can envisage some difficulty in assessing whether these objectives were being effectively met. For example, an interaction between a DNSP and its contestable affiliate might not at the time give the appearance of being discriminatory, or providing an unfair advantage. However, when judged with the benefit of hindsight, it is possible that the same interaction might be one that had clearly breached one or more of these objectives. How should such a transaction then be judged?

ENGIE believes that rather than express the objectives in terms of the effect (cross-subsidies, discrimination, unfair advantage) a better objective might be more specific statements of the level of separation required. For example, effective legal and financial separation between regulated and contestable entities.

As stated previously, ENGIE believes that the most effective objective would be one of structural separation. If the AER continues to take the position that this is not within the scope of the ring-fencing guidelines, then the objectives should be written in a way that goes as close as possible to achieving this outcome.

Question 3: Do you agree with the service classification approach to ring-fencing which is discussed in section 3.3? Is there a better alternative?

ENGIE supports the approach to service classification which assumes that ring-fencing is beneficial to consumers, and that the default position is that all contestable services offered by an NSP will be ring-fenced.

Of the alternative approaches outlined in the position paper for specifying exactly which services would be subject to ring-fencing, ENGIE favours the classification approach (rather than a pre-defined service list or a broad



definition), as it allows the AER to consider the specific requirements at the time that the AER considers the regulatory proposal from the NSP.

Question 4: Does the proposed approach to ring-fencing adequately deal with the prospects for development of the contestable market for DER?

ENGIE believes that the development of contestable markets for distributed energy resources will be impeded if NSPs are allowed to take advantage of their monopoly position as this will deter or potentially block potential new entrants.

Robust ring fencing arrangements are therefore an important pre-requisite to achieving effective competitive outcomes in the provision of DER.

Question 5: Are there other ring-fencing obligations we should impose on NSPs that provide services into contestable markets?

As discussed previously, ENGIE would prefer that structural separation would be required for participation in the contestable sector.

The proposed ring-fencing obligations could be enhanced by the inclusion of a restriction on regulated businesses using their IT systems and databases for contestable services.

Question 6: What costs would be incurred in meeting these obligations?

It is important to give consideration to the cost imposition of ring-fencing obligations as well as the likelihood of these obligations being effective or enforceable. It is conceivable that some of the obligations could be adopted by NSPs simply giving undertakings to conform, but with little or no processes in place that would enable them to confirm adherence. The more that NSPs are required to be able to demonstrate conformance (which ENGIE would argue is important), the greater the complexity and costs.

Although it is conceivable that the costs for a robust and enforceable ring-fencing regime could be significant, this should not be seen as a reason not to pursue adequate ring-fencing. The potential costs to consumers that would arise through failing to allow competition to flourish in the emerging areas such as distributed energy, storage and metering are likely to be far greater than the costs of adopting robust ring-fencing arrangements.

Question 7: Should assets sharing be restricted between regulated services and contestable service provision?

In principle, asset sharing between regulated and contestable services might be acceptable on the basis that it is the services rather than the assets that need to be appropriately regulated. This raises questions about how the asset is financed in the first place, and ongoing operational and financial control.

For example, if an NSP receives regulated CAPEX to build an asset for a network (regulated) service, and then allows another party to use the asset for some competitive services, the NSP would most likely then receive a payment for the competitive service. This would need to be taken into account in assessing the NSPs regulated income.



Question 8: Do the factors set out above reflect the issues we should consider in deciding whether to grant a ring-fencing waiver?

ENGIE believes that the position paper sets out the appropriate issues for the AER to consider in its deliberations.

Question 9: In which circumstances should the customers of ring-fenced services and not customers of the DNSP's services in general pay the additional costs of complying with ring-fencing obligations?

ENGIE believes the key point is that the customer must have choice. If the customer decides to accept a contestable service offering from a ring-fenced NSP provider, and in doing so, accepts that the cost of the services will include ring-fencing compliance costs, then this would be appropriate, provided there is an alternative contestable provider.

ENGIE trusts that the comments provided in this response are of assistance to the AEMC in its deliberations. Should you wish to discuss any aspects of this submission, please do not hesitate to contact me on, telephone, 03 9617 8331.

Yours sincerely,

A handwritten signature in black ink, appearing to read "C. Deague". The signature is fluid and cursive.

Chris Deague
Wholesale Regulations Manager