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

PRELIMINARY POSITIONS PAPER

AER Ring Fencing Guideline

Dear Mr Pattas,

Metropolis Metering Services Pty Ltd (Metropolis) is an AEMO accredited Metering Provider and Metering Data Provider with a significant volume of contestable advanced meters installed across homes and businesses in all states and territories in the NEM.

As an independent Meter Provider for almost 10 years, Metropolis has unique, practical experience in the application of existing ring-fencing rules. The results of this review and guideline will shape the competitive landscape for the critical starting of Competition in Metering, and hopefully result in a significant improvement in regulatory certainty for contestable service providers seeking to enter the market.

Please find in the attached appendix, and in provided examples document, Metropolis's feedback regarding the preliminary positions paper to the AER Ring Fencing Guideline.

Sincerely,

Charles Coulson

Regulatory Manager
Metropolis Metering Services

Overview

Metropolis strongly support this review and support significantly strengthening the ring fencing guidelines and enforcement regime. One key area of focus right now is smart meters. This has been a contestable market for decades, however the weakness in ring fencing, amongst other things, has suppressed market development and largely constrained contestable metering to the low-volume large customer market.

Recent Rule changes will likely have the impact of changing the contestable metering market to low-margin/high volume. This means that small impacts on costs due to ring-fencing failures will greatly affect the viability of contestable metering providers. Other competitive services on the horizon are likely to have similar difficulties, such as energy storage and EV charging management.

Attached to this submission Metropolis provide a series of examples of where we have seen regulated service providers engaging in behaviour which is detrimental to contestable markets (some within current guidelines, some not). The rigour, enforceability and penalties within the ring-fencing guidelines are fundamental to the extent that this behaviour continues.

This submission comes in two parts: answering the questions proposed by the AER in the preliminary positions paper, and a series of actual examples and scenarios which have been encountered by Metropolis. The second part highlights specific organisations and individuals and should be treated as confidential.

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

Metropolis consider that the current ring-fencing arrangements have largely been ineffective.

While there has been a level of guidance, Metropolis consider it to frequently be well below sufficient to allow a level playing field or encourage significant competition for many services. By ring-fencing specific customer-facing services, there are many gaps that allow discriminatory or market-damaging behaviour.

There is no meaningful monitoring of ring-fencing compliance, limited channels for grievances, and the penalties associated with discriminatory behaviour are non-existent.

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

Metropolis consider that the objectives are too limited. Each of the first three objectives should not just consider the effects, but the perception of unfair advantages. The overarching objective is to "promote an even playing field that may encourage market

entry". Confidence in the ability to compete on an even level is of critical importance when considering market entry, and this is based on the perception of an even playing field.

Additional objectives should be developed, that consider unfair advantages in the areas of:

- Information provision to consumers, retailers, third party service providers (including electricians). Regulated businesses have an ability to influence decision making in many realms. Their history as the ultimate authority on the electrical safety, standards and the electrical industry continues to carry excessive influence in almost every aspect of the provision of electrical services. This influence is routinely used to advantage related competitive businesses.

  See example 2.1

- Regulated service providers have a significant level of authority regarding the making and circulation of rules, which allow them to do two things:
  - Confer advantages on related entities. For example, when a bulletin is posted by a regulated service provider, this is considered to be mandatory by most electricians. In some cases the bulletin notifies electricians of regulatory changes, but in other cases it notifies electricians of the regulated providers internal processes – which are the same as it's related entity, but different to other contestable providers. Ie, the regulated provider can (and do) create the appearance of regulatory barriers, where none actually exist.

    See Examples, 2.2.

  - Dampen the uptake of contestable services overall. It needs to be clear that some regulated services (such as basic metering) are a viable alternative to contestable services. Metropolis's biggest opportunity (and thus competition) is not the thousands of meters owned by contestable providers; it's the millions of basic metered sites.

    The use of regulatory authority granted to regulated service providers to restrict competitive markets is inappropriate. While these are not "end user" services, Metropolis propose that they should be considered under ring-fencing restrictions.

    See Examples 2.3

Metropolis

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?

Metropolis are of the view that the guideline should provide a two-step guidance.

1) A general, enforceable, requirement for regulated service providers to not engage in behaviours which is discriminatory or restricts competition.
2) Guidance on specific services, such as the classification approach described in the preliminary positions paper.

The reason for the general enforceable requirement is that no matter the rules or guidelines provided, the approach typically taken by regulated service providers is to operate strictly to the rules, irrespective of the impact on the market.

The object of a general guideline is to make regulated providers responsible for the outcome of their actions, rather than the action itself. This forces a level of self-regulation and prevents significant efforts to "find the loopholes": If a regulated provider seeks to gain advantage through a gap in the service specific guidelines, they risk penalties based on the overall outcome.

The approach of service classification is appropriate to support the implementation, however Metropolis have some concerns:

- 5 year time frame for review is generally sufficient. But, there needs to be an ability to assess services in a shorter timeframe, if required. This is particularly important for new technology and services, and regulatory change. Both of which can have significant impacts on the market within the 5-year review period.

- The classification of services is different between each LNSP. This means that some services will be ring-fenced in one network area, but not another. Effectively, ring-fencing will not be national, and potentially not even jurisdictional.

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

No. Structures where a regulated service provider can create a "separate", wholly owned legal entity, to provide unique (and thus almost impossible for the AER to assess the efficiency) services to itself make a mockery of ring-fencing.

The information and relationship asymmetry between the wholly owned subsidiary and any independent third party is extreme. The ability for any third party to even provide information to the AER on the efficient costs for providing the service is constrained, as third parties are unlikely to even bid for work against such a subsidiary.

See example 4.1

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

Yes,

- It should go without saying that discriminatory cross-branding/advertising should not be allowed between regulated and contestable service providers.
- Access to services should be available equally to any party.
- No services should be procured from related entities without a transparent tendering process.

See examples 5.1 and 5.2

Question 6: What costs would be incurred in meeting these obligations?
In order to assess the costs of meeting these obligations, it is also necessary to know the cost of not applying them. Ie, how much value would be created by having additional service providers competing, and how must of that value would be lost by having less stringent ring-fencing guidelines.

The positions paper outlines the high level concerns with the current ring-fencing approach, but it is not clear that there is a strong understanding of the cost associated with restricted competition.

Metropolis is concerned that the high visibility of the cost of meeting ring-fencing obligations may unduly influence the outcome of the review process. Without equally visible benefits of ring-fencing, it will be very difficult to accurately assess the net benefits of different options for ring-fencing.

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

Yes. As described in the preliminary positions paper, Metropolis's view is that the current ring-fencing rules have not been effective and enforcement is non-existent.

Regulated service providers have a significant informational advantage over the AER when it comes to assessing shared assets. This makes it almost impossible for the AER to accurately assess the cost-sharing models provided by the regulated service providers.

This informational disparity, along with a history of combative interactions between regulated service providers and the AER, suggest that any asset sharing would be biased towards the regulated service providers.

It may be possible that asset sharing does not need to be restricted, however this would require sufficient obligations on regulated service providers, and enforcement and penalty

regimes. The overall framework would need to be rigorous enough to incentivise regulated providers to provide accurate information, and act in a manner that encourages a level marketplace.

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

Metropolis are comfortable that these factors are appropriate.

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?

Metropolis agree with the AERs view that,

1) The cost of compliance should not be significant, and
2) No costs related to the provision of contestable services, including ring-fencing, should be borne by parties receiving regulated services.

Question 10: How else could the AER minimise the administrative cost of ring-fencing while maintaining the integrity of its approach?

It is difficult to imagine that the current combative approach to ring-fencing will provide optimal outcomes. There will be a continuous challenge by regulated service providers to find and abuse loop-holes, while the AER will be attempting to identify and close said loop-holes. This reactive and ongoing process is likely to result in poor outcomes for all parties.

Creating general, enforceable, obligations as described in Q3 would provide a stronger base-line for ring-fencing than that proposed in the preliminary positions paper. The approach would encourage regulated service providers to support market development – as anything else can be penalised.

In the long run, Metropolis view this as a significantly superior outcome, which minimises the overall cost of administration.

Question 11: Is it reasonable for the AER to consider these transitional arrangements to the new ring-fencing guideline?

These arrangements are reasonable. It should be noted that the 1-year timeframe will coincide closely with the effective date of Competition in Metering and Embedded Network Rule changes. It is important that appropriate ring-fencing is in place when these begin, so the transitional period should not be longer than this.

Question 12: How can we ensure ring-fencing compliance is robust and effective without imposing excessive costs that may ultimately be borne by consumers?

Other Issues

Metropolis fundamentally objects to the concept of regulated service providers being granted waivers to perform R&D. This has occurred in the past, and has been ineffective.

The fact that a waiver is required indicates that the R&D cannot generate commercial returns without a contestable service provider being involved. As such, it does not make sense that the contestable service providers should be involved in the initial activities. There is a strong desire by many market participants and potential new entrants to support advanced energy initiatives.

Where research is performed without including contestable service providers, then the only party with the knowledge and capability to commercialise the research is the regulated service provider itself. This prevents any third party contestable provider from competing on a level playing field with a ring-fenced regulated service provider.

It is possible that a regulated service provider cannot gain sufficient interest from a contestable service provider to support R&D work. This would immediately raise the question of how valuable the work is, but assuming it was deemed to be valuable, then the regulated service provider could request an exemption, providing evidence of attempts to gain support from contestable providers.

See example 12.1

Metropolis support a mechanism to review ring-fenced services outside of the routine 5-year regulatory control period.

Reporting, compliance and enforcement

Metropolis support the self-reporting measures identified. However these do not address compliance or enforcement, and only partially cover reporting (from the perspective of financial transactions between regulated and competitive arms of an organisation). This does not provide any reporting on the ability for a regulated entity to negatively affect the operating environment for other competitive service providers.

It is not clear how the proposed reporting would work. Any services that are identified by the AER as competitive services would clearly be included in the annual reporting. But there are secondary services offered by regulated service providers that are sufficiently minor that they do not appear on the AERs reviews, which are competitive. So, what will the self-reporting cover?

See Example 12.2

Metropolis propose a third party reporting mechanism in addition to self-reporting. Due to the scale and scope difference between regulated service providers and many competitive providers, activities that result in advantages for a ring-fenced or regulated entity can be simply hidden in high level reporting.

Contestable metering is changing. Margins are shrinking and numbers of meters are growing. A minor difficulty in routinely dealing with a regulated service provider will dramatically change the economics of performing metering work.

This doesn't occur at a financial level, but at a field-work level. There is no way that self-reporting, as proposed, will even identify the issues, let alone prevent them from occurring.

See example 12.3

Metropolis strongly support pecuniary penalties. Frequent minor and operational level breaches will dramatically influence the effectiveness of the new high-volume market, and significantly undermine confidence in the regulatory and compliance regimes. An annual report based on accounting information will be ineffective at addressing this sort of behaviour. Minor pecuniary penalties have been effective at encouraging correct behaviour in many aspects of the industry (Retailers and DNSPs in relation to customer billing and wrongful disconnections, supported by the AER and Ombudsman schemes).

Currently it is possible to take legal action, or submit complaints to the AER requesting action, however these are time consuming, and thus expensive. They are also a disproportional measure for the majority of the anti-competitive concerns that a competitive service provider face.

If pecuniary penalties do not exist, what enforcement regime would? The current approach of warning then legal action as the only recourse has proven to be relatively ineffective, as the breadth of current issues demonstrates.

Summary

Metropolis support the objective and intention of this review, however the proposed solution does not appear to be sufficient to resolve the existing issues.

- Additional broad obligations are required to make regulated service providers responsible for outcomes, rather than individual services.
- A reporting approach to uncover routine operational issues, as distinct from financial breaches, is required.

- An enforcement mechanism that is suitable for dealing issues that are insufficient to warrant court action.

Without these additional elements, the ring-fencing rules will not effectively "promote an even playing field that may encourage market entry".

END