18 January 2016

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

Dear Mr Pattas

RE: SUBMISSION TO ENERGEX APPLICATION FOR A RING-FENCING WAIVER

Origin Energy (Origin) appreciates the opportunity to provide input to the Australian Energy Regulator's (AER) assessment of an application submitted by Energex for a waiver from section 1(b) of the Electricity Distribution Ring-fencing Guidelines issued by the Queensland Competition Authority (QCA).

The objectives of the QCA's Ring-fencing Guidelines is to create an environment where competitive and potentially competitive markets are not uneconomically biased by the vertical integration of distribution and other businesses, whatever that level of integration might be.[1]

The emergence of storage technologies to residential customers and small business on a commercial basis is relatively recent and was not fully anticipated when the QCA's Ring-fencing Guidelines were originally developed. On the basis that these services are relatively untested from a ring-fencing perspective and are an important emerging supply market, it is necessary that when assessing this application that the AER adopt a cautious approach to avoid setting a regulatory precedence that may have unintended long-term consequences to competition; especially ahead of its review of national ring-fencing guidelines.

Energex argue that because its project does not produce electricity, and there is no intention to make a profit, it is not carrying on a related business. However, this activity does involve a commercial return (through regulated revenues) and it does involve the production of energy from either PV generation or battery storage (both competitive markets) that is consumed directly by a customer.

Ring-fencing requirements must apply in any instance where a regulated business seeks to operate in a competitive environment. This is particularly relevant for emerging technologies such as storage solutions which involve the competitive supply of services behind the customer's connection point (i.e. beyond the distribution network). Any encroachment by monopoly networks has the potential to deter and/or prevent new players from entering this market and must be assessed accordingly.

For these reasons, the AER has a responsibility to ensure that the QCA's Ring-fencing Guidelines are applied as intended to ensure that any expansion of a regulated business into competitive markets does not result in a lessening of competition in those markets.

Energex Proposal

Energex's application relates to three Battery Energy Storage System (BESS) pilot projects where batteries are used in conjunction with solar PV to provide Energex with an understanding of the impact of these investments on its network, which it argues will provide insights for future capital investment.

[1] QCA, Final Determination Electricity Distribution: Ring-fencing Guidelines, September 2000, p. 8.

Origin Energy Electricity Limited ABN 33 071 052 287 • Level 45, Australia Square, 264-278 George Street, Sydney NSW 2000
GPO Box 5376, Sydney NSW 2001 • Telephone 02 8345 5000 • Facsimile (02) 9252 9244 • www.originenergy.com.au

All three projects involve the installation of both solar PV generation and batteries at the customer's premises (Energex as the customer). Energex intends to fund these projects through the Demand Management Innovation Allowance put forward in its regulatory proposal.

The BESS pilot projects involve the generation of electricity, which is not permitted under the Ring-fencing Guidelines. However, Energex states that it does not consider this constitutes a related business because Energex is not producing electricity with the intention of making a profit. It states that the vast majority of the electricity produced will be used onsite. For this reason, Energex argues that these activities are being undertaken as part of carrying on a distribution business.

QCA Ring-fencing Guidelines

The Ring-fencing Guidelines allow a regulated business to obtain a waiver from operating a related businesses within its legal entity provided that it can demonstrate that the administrative costs to it and its associates of complying with the obligation outweighs the benefit or any likely benefit to the public.

The QCA Guidelines do not provide guidance with which to determine benefit, however, it signals its support for the approach adopted by the Australian and Competition and Consumer Commission (ACCC).[2]

In its Authorisation Guidelines, the ACCC includes the detriment from any lessening of competition as a public cost.[3] We believe the potential lessening of future competition is a key aspect of this application.

Public Benefit

Origin recognises that the range of public benefits may be broad. However, we note that most public benefits that have been accepted by the ACCC can be attributed to improvements in economic efficiency.[4] In this regard, we consider that economic efficiency is best enhanced by promoting competition.

Energex has not demonstrated any public benefit that will accrue as a result of being granted a waiver from the Ring-fencing Guidelines.

Administrative Costs and Public Detriment

As stated above, economic efficiency is best enhanced by promoting competition. Public detriment therefore occurs where competition is lessened, which results when firms with market power, such as regulated monopolies, have a degree of freedom from competitive constraint.

As noted by the QCA, the separation of monopoly and contestable services provides a number of benefits. Namely, new players in the contestable elements of the market will be able to compete on a fair and equal basis, without fear of vertically integrated incumbents being able to gain a competitive advantage, thereby creating confidence in the integrity of the market.[5]

Competitive advantage through market power is not a physical asset or a commercial instrument the use of which can be observed. Market power is an economic concept, describing the state or condition of a market.

The condition of the market for storage solutions is immature but is emerging through increased numbers of entrants and an expansion of products and services. Allowing the market to mature and

[2] QCA, Final Determination Electricity Distribution: Ring-fencing Guidelines, September 2000, pp. 14-15.
[3] ACCC, Authorisation Guidelines, June 2013, pp. 56-57.
[4] ACCC, Authorisation Guidelines, June 2013, pp. 58.
[5] QCA, Final Determination Electricity Distribution: Ring-fencing Guidelines, September 2000, p. 8.

grow will result in increased competition which will create greater pressure on service providers to compete on levels of service, innovation and price. That is, where impediments and constraints are removed competition will evolve as a process.

The ACCC recognises that in many cases it will not be possible to credibly quantify public detriments. However, the ACCC also note that there must be a sufficient basis for concluding that the benefits and detriments are likely to result.[6]

In practice, this is likely to involve making a judgment about the existence and size of the public benefit and detriment. These are often based on a set of indicators such as set out by the ACCC it is Authorisation Guidelines.

Energex has not provided an assessment of public benefits, detriments to competition, or submitted administrative costs associated with complying with section 1(b) as required by the Ring-fencing Guidelines to obtain a waiver.

Closing

The objectives of the QCA's Ring-fencing Guidelines are to create an environment where competitive and potentially competitive markets are not compromised by the participation of a regulated distribution network.

The market for storage solutions is immature but is emerging. Allowing the market to mature and grow will result in increased competition which will create greater pressure on service providers to compete on levels of service, innovation and price.

Caution must be exercised in allowing regulated businesses to participate in competitive supply activities beyond their network boundaries, especially in new and emerging markets. To do otherwise will raise doubts with smaller operators whether they are able to compete on a fair and equal basis. This will erode confidence in new entry and ultimately lessen competition in any emerging market.

To obtain a waiver from the obligations of section 1(b) of the QCA Ring-fencing Guidelines, an applicant must demonstrate that the administrative costs to it and its associates of complying with the obligation outweigh the benefit or any likely benefit to the public.

Energex has not provided an assessment of public benefits, detriments to competition, or submitted administrative costs associated with complying with section 1(b) of the Ring-fencing Guidelines. As a result there is no basis for the AER to assess this application. For these reasons, we believe that Energex's application for waiver does not meet the waiver application requirements set out in the Ring-fencing Guidelines and therefore cannot be approved in its current form.

If you have any questions regarding this submission please contact Sean Greenup in the first instance on (07) 3867 0620.

Yours sincerely

Keith Robertson
Manager, Wholesale and Retail Regulatory Policy
(02) 9503 5674 keith.robertson@originenergy.com.au

[6] ACCC, Authorisation Guidelines, June 2013, pp. 64.