



8 July 2021

Mr Mark Feather  
General Manager  
Australian Energy Regulator  
GPO Box 520  
Melbourne, VIC, 3001

Email: [AERringfencing@aer.gov.au](mailto:AERringfencing@aer.gov.au)

Dear Mr Feather,

**RE: SUBMISSION TO AER DRAFT RING-FENCING GUIDELINE**

Origin Energy (Origin) appreciates the opportunity to provide a submission to the Australian Energy Regulator's (AER) electricity distribution draft ring-fencing guideline (the guideline).

Origin considers that effective ring-fencing of distribution network service providers' (DNSPs) and their affiliates operating in competitive environments is essential in promoting the long-term interest of consumers. Accordingly, Origin is supportive of the AER's updating of the guidelines where appropriate.

We agree with the AER that:

*The objective of ring-fencing is to provide a regulatory framework that promotes the development of competitive markets, by providing a level playing field for third party providers in new and existing markets for contestable services.<sup>1</sup>*

We consider that the proposed changes to the guideline are largely consistent with promoting this objective while also seeking to balance with consumer benefits. However, the default position in relation to stand-alone power systems (SAPS) and storage devices should be competitive provision. Any exemption or waiver process should be considered a short-term initiative until such time as the competitive market is sufficiently developed. Effective competition policy and the promotion of competition is the most efficient means of promoting the long-term interests of consumers. The focus of the AER should be on facilitating the competitive market, ensuring that third-party providers are afforded every opportunity to participate and that access to the market is available on equal terms.

Our response to selected stakeholder questions is provided below.

**Stand-alone Power Systems**

The current guideline allows DNSPs to provide distribution services but does not allow them to provide non-distribution services, including SAPS. As highlighted by the AER, there are some circumstances where a third party is either unwilling or unable to offer SAPS services, particularly in remote locations. In addition, the AER highlight that demand for SAPS over the next 5 to 10 years is expected to be relatively high and continued deployment through the ring-fencing waiver process is unlikely to support timely provision. To facilitate the efficient provision of SAPS in these circumstances, the AER proposes to allow DNSP-led SAPS under an exemption framework without the need for a waiver.

---

<sup>1</sup> AER, 2021, *Draft electricity distribution Ring-fencing Guideline Explanatory statement*, May, p.9.

We consider that long-term consumer benefits are maximised through competitive provision of contestable services. While competitive provision of SAPS is our preferred option, under current circumstances we appreciate the need for pragmatism, at least in the short-term. Where it can be demonstrated that third-party provision is unavailable we accept that alternative arrangements may be necessary to facilitate timely provision of services to customers.

We consider that a well-designed exemption process will provide benefits to both DNSPs and customers by providing certainty and clarity to DNSPs and expediting potential service provision to customers. However, we agree with the AER that it is important that potential competitive provision is accommodated where possible within the process.

The AER's proposed use of a generation revenue cap on SAPS seeks to strike a balance between the needs of customers and the development of a competitive SAPS market. The AER's initial proposal is to set a generation revenue cap based on 75 per cent of the forecast SAPS proposed for deployment by DNSPs. In doing so, the AER expect that DNSPs will be incentivised to test the market and thus provide some scope for third party providers to supply the unmet demand. In recognition of the differences in demand for SAPS between distribution regions, the AER have also proposed a tiered approach to the application of the generation revenue cap to address additional SAPS demand in regional areas. Where a DNSP expects to exceed the generation revenue cap, a DNSP may seek a waiver to the generation revenue cap exemption. We consider that this represents a reasonable approach at this time, however we stress the importance of ongoing monitoring by the AER to ensure the proposed regime is operating as intended.

Origin anticipates the competitive outlook for SAPS provision to change in the future as the market for the supply, deployment and ongoing operation of SAPS develops. As a result, on-going reporting and monitoring of SAPS deployment, the effectiveness of the proposed exemptions framework, and in particular the potential for third-party involvement is critical. We consider that DNSP reporting requirements should focus on providing sufficient information to allow stakeholders to understand how the SAPS market is developing and identify opportunities for third-party involvement.

We consider that the AER's proposed DNSP reporting requirements provide a reasonable starting point for DNSP-led SAPS. While we appreciate that it is difficult to predict when a review of the guideline may be required, we consider it necessary for the AER to routinely review information to ensure the framework is operating as intended. In particular, we consider it necessary for the AER to monitor:

1. the demand for SAPS, including the prevalence of rural locations and whether the proposed revenue caps remain appropriate;
2. the provision of SAPS to customers to ensure these are being provided in a timely manner;
3. the information provided to potential third-party providers is sufficiently detailed to allow providers to identify potential opportunities to participate;
4. the extent and effectiveness of market testing to ensure opportunities for third-party provision of SAPS are maximised; and
5. the development of the competitive market for the provision of SAPS (or elements of SAPS such as operation, maintenance etc) and overall participation of third-party providers in the provision of SAPS services.

As discussed, we consider that competitive provision is the preferred option and most effective means of maximising long-term consumer benefits from the provision of SAPS. The DNSP reporting requirements should provide the AER with sufficient information to assess the development of the competitive market and determine if third-party providers are afforded sufficient opportunity to participate.

### **Contestable services from batteries**

The AER states that its aim is to develop a ring-fencing framework for batteries that promotes the competitive provision of contestable services using batteries. Accordingly, the AER's draft position is to prohibit DNSPs from providing contestable services with a battery. We are fully supportive of this approach.

We consider there is the potential for significant growth in the use of storage devices and an active and growing market for competitive provision of storage devices. Consistent with economic theory, we consider that the competitive market will deliver the most efficient consumer outcomes, particularly in terms of price and consumer choice.

While we appreciate that the competitive market for SAPS is still developing, we consider that the long-term interests of consumers are best served through fostering the development of the competitive market. DNSP involvement in the market has the potential to stifle that development, even if inadvertently. We consider that, to the extent DNSPs seek to participate in the competitive market, they should do so on a level playing field i.e. via an appropriately ring-fenced entity. Alternatively, DNSPs may procure the benefits of storage options through commercial arrangements with other service providers.

Rather than investing in assets in their regulatory asset base whose functionality can only be partially realised through network benefits, DNSPs should be encouraged to procure the benefits of storage devices as services from the contestable market. For example, storage devices could be provided by third-party providers through competitive tender, with the DNSP reserving priority use of them for network support for an agreed number of days per annum at their call. The remaining battery capacity could be used by the provider or auctioned to retailers. This type of arrangement provides network support benefits while preserving the integrity of the competitive market and hence long-term consumer benefits. There is no "leakage" to the process through the involvement of DNSPs in the competitive market or the application of ring-fencing. We see this as a workable solution and reiterate that there is no imperative for DNSPs to be involved in the competitive provision of storage devices.

We also support the AER's proposal to clarify the application of shared asset rules by removing batteries owned by DNSPs from the scope of this exception. Consistent with the AER, we consider the supply of excess battery capacity to third parties is inconsistent with the original intent of the shared asset rules.

Notwithstanding the above prohibition on DNSPs providing contestable services with a battery, the AER suggests that there may be value in a single battery providing both regulated network services and contestable services. To test the proposition, the AER proposes to allow a DNSP to apply for a waiver in situations where a DNSP wants to supply excess capacity of a battery to a third party where it considers the benefits outweigh the harm. The waiver process effectively requires DNSPs to demonstrate the consumer benefits from DNSPs owning the battery and the risks to competitive provision can be mitigated.

As discussed, in principle, we do not support competitive provision of batteries by DNSPs and consider the long-term interests of consumers are best served through competitive provision. It is important that the AER remain focused on long-term benefits, rather than short-term gains. While we appreciate that the storage market is still developing and its roles and functions are not settled, allowing DNSPs to participate in competitive provision of batteries has the potential to impact current and future competitive provision. We are unable to conceive a situation where competitive provision is unavailable or where DNSP provision is preferable and would expect waiver applications only in exceptional circumstances.

We understand that the proposed waiver process seeks to place the onus on DNSPs to demonstrate the benefits of DNSP ownership and that competition impacts can be mitigated, including through controls on discrimination and appropriate cost allocation. While we acknowledge the intent of the waiver assessment information, we are concerned that DNSPs will take advantage of the waiver process

particularly given the information asymmetry that exists in favour of DNSPs. In addition, we consider that any cost allocation applied by DNSPs should be rigorously reviewed. The AER acknowledges that providing a waiver compromises its ability to verify whether a cross subsidy exists because the AER's compulsory information-gathering powers do not extend to other services a DNSP might offer. Given their broad nature, we consider compliance with approved Cost Allocation Methodologies (CAMs) to be a first-order requirement – a lower-level detailed assessment of cost allocation is required to ensure that there is no cross subsidy between regulated and unregulated businesses.

Our preference is for legal separation between the DNSP and any competitive storage services it provides. Notwithstanding, in order to address cross subsidy concerns we consider there needs to be greater prescription in the means for allocating costs between different services. In particular, the process should focus on providing greater transparency over transactions between the different service providers. Given the potential adverse impact on competitive providers created by cross subsidisation, we consider that the AER requires greater oversight of costs in both the DNSP and the competitive service provider than provided under the CAMs. In addition, we consider that the typical materiality conditions applied in the CAMs are not appropriate when assessing cross subsidisation toward the DNSPs' competitive services. Any advantage to the DNSPs' competitive service provider, no matter how small, has the potential to disadvantage competing third-party providers and result in sub-optimal consumer outcomes in the long-run. Accordingly, we consider that no materiality threshold should be applied when assessing costs allocated between DNSPs and their competitive service providers.

In addition to an enhanced cost allocation process, we support a comprehensive compliance framework which will ensure that the development of all contestable energy services is not undermined by cross subsidies or discrimination.

We consider that the default position needs to be competitive provision of storage devices. A stringent burden of proof must be applied to DNSPs with any waiver application, particularly regarding demonstrating that competitive provision is not a viable option. To this end, we consider that DNSPs should be required to demonstrate that extensive market testing has occurred, including the market testing process undertaken and information provided to potential providers.

At best, we consider the AER's proposed waiver approach to storage devices to be a short-term initiative until such time as the competitive market is sufficiently developed. The AER should focus on facilitating competitive provision by ensuring that the framework provides equal opportunity for all participants. DNSPs should be seeking to provide sufficient information and the facilitating infrastructure to assist competitive provision rather than seeking to enter the competitive market themselves. Any entry to the market by DNSPs should be on competitively neutral terms.

In addition to the above, the AER also proposes to insert a new clause in the guideline to prevent a DNSP from discriminating between two parties where it owns the asset. We support the extension of non-discrimination requirements to cover discrimination against competitive storage service providers. Non-discrimination is essential to ensure that all participants can compete for the provision of services on a level playing field. To be effective, it is essential that the AER ensure demonstrated compliance with the proposed provision. We seek further information on how the AER intends to monitor compliance.

### **Improving the guidelines**

We are supportive of the AER amending the guideline to improve understanding and reduce the administrative burden, including:

- providing more detailed reporting of staff sharing arrangements to ensure that information is not inappropriately shared with related providers;
- clarifying the type of information that can be shared by a DNSP;
- clarifying the process for reporting breaches of the guideline. We agree that that the reporting of all breaches will eliminate uncertainty associated with determining materiality; and

- retaining the approach to branding to ensure affiliates do not receive an unfair advantage from their association with the parent DNSP.

If you have any questions regarding this submission, please contact Gary Davies in the first instance at [gary.davies@originenergy.com.au](mailto:gary.davies@originenergy.com.au).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Sean Greenup', written over a light grey rectangular background.

Sean Greenup  
Group Manager Regulatory Policy  
(07) 3867 0620 [sean.greenup@originenergy.com.au](mailto:sean.greenup@originenergy.com.au)