The Australian Energy Regulator

AER Ring-fencing Guideline

Submissions workshop

27 October 2016

AUSTRALIAN ENERGY REGULATOR

Workshop outline

- AER staff will run through the main elements of the Draft Guideline
- We will highlight key issues raised in submissions
- Participants are welcome to speak to their submissions
- All stakeholders are invited to contribute, but we will be focussed on issues raised by stakeholders in their submissions

Rules of engagement

- We would like today to be an informal discussion – so not too many rules!
- AER Board is here to listen and participate
- Seats at the table are prioritised for those that made submissions
- All are welcome to contribute!
- Please say who you represent
- We will take some notes today but do not intend to attribute comments to individuals or organisations

Exposure draft

- We are planning to publish an exposure draft of the final guideline on 7 November (approximately)
- We will provide one week for comment prior to finalising the guideline
- Our reasons for the exposure draft will be published in an Explanatory Statement at a later date along with the final guideline.
- We would appreciate limiting your submissions to critical issues only

Key elements of draft guideline

Terms and definitions

- Many submissions raised concerns over some terms used in the Draft. We intend to remove some of these terms in the final guideline. For example;
  - 'network services' will be removed and replaced
    - a DNSP may provide distribution services and transmission services but not 'other services'
    - 'other services' means other than distribution or transmission services
  - 'energy related services' will become 'other electricity services'
  - 'other services' instead of 'non-distribution services'
  - 'affiliated entity' instead of 'related bodies corporate' and we will define 'affiliated entity' broadly

Issue 1 – Legal separation

- Draft Guideline – DNSP can only provide network services
  - legal separation supports prevention of cross subsidies, in concert with accounting separation and cost allocation. No waivers allowed.
- Submissions:
  - What about partnerships?
  - CAMS and reporting transactions between business units are sufficient
  - No benefit from separation where non-distribution activities are also regulated
  - Full legal separation is critical
  - Too restrictive on what DNSPs can do (refer issue 3)

- Questions – Should we consider any waivers to the requirement for legal separation? If so, under what conditions?

Issue 2 – Threshold for legal separation

- Draft Guideline – DNSP may provide non-network services if the total annual costs do not exceed $500,000. These activities must be reported. Cross subsidies are not permitted.
- Submissions:
  - Undermines the intent of ring fencing
  - Exclude shared assets revenue
  - Threshold too arbitrary and too low
  - Move from fixed threshold to a percentage - like transmission 1% of revenue
  - Base threshold on forecast costs
  - Not justified at all
  - Restrict to "incidental"
  - Raise to $1 million per service
- Question: What is the risk the threshold, which was designed to provide flexibility, will be misused?

Issue 3 – Does legal separation restrict service provision?

- Draft Guideline – DNSPs can only provide network services
- Submissions:
  - Will prevent use of shared assets – two guidelines are in conflict
  - Will restrict ability of DNSP to provide shared services
  - Restricts staff sharing
  - Economies of scale will be lost, cost to customers
  - Not efficient

- See separate slides
- Questions: Does legal separation restrict the efficient use of DNSP assets and resources? Is the Ring-fencing Guideline in conflict with the Shared Asset Guideline?

Issue 4 – Brand separation

- Draft Guideline – must have independent and separate branding of the DNSP from a relate body corporate (affiliate)
- Submissions:
  - Branding provisions should be strengthened
  - Waivers should be allowed
  - Where staff/location waivers have been granted, so should waivers for co-branding be permitted
  - Not realistic – not possible to divorce DNSP brand from related entity
  - Separate branding will confuse customers
  - Co-branding does not cause harm
  - Brand restrictions will be complex to implement – must allow substantial time to implement – 18 months
- Questions – should allowance me made for existing brand names that are ‘close’? Is any difference in names sufficient?

Issue 5 – Office separation

- Draft Guideline – DNSP must have a separate office (different building) from an affiliate that offers ‘other electricity services’.
- Submissions:
  - Not necessary
  - Expensive
  - Only apply restrictions to prevent staff mixing
  - Separate locations sufficient, separate building excessive

- Question: is the current IPART approach to office separation sufficient? That is a separate office is:
    - A different building, or
    - A separate entire floor of a building, or
    - A separate part of a building with secure access to restrict staff access

Issue 6 – 'Regional depots'

- Draft Guideline – Waivers for staff and office separation can be applied for. Most likely justified in rural/regional situations where there is no competition. In particular, 'regional depots'.
- Submissions:
  - No waivers are acceptable
  - Restriction to 'other electricity services' (e.g. non-distribution)
  - Impractical if waivers reviewed routinely – creates risk
- Question – how do we achieve consistent waiver outcomes in the long term interests of consumers? Suggest:
  - Criterion 1 – potential for (or lack of) competitive market
  - Criterion 2 – cost of not providing waiver
- Option 1 – case by case assessment of each waiver
- Option 2 – waiver allowed if depot 100 km from city
- Option 3 – general exemption for regional depot but a third party could apply to remove exemption

Issue 7 – Staff separation – unregulated distribution services

- Draft Guideline – 4.2.2(b)(iv) – this exemption allows staff involved in direct control services to also be involved in the provision of unregulated distribution services.
- Submissions:
  - Should be extended to office sharing
  - Does not make sense
  - Requires clarification
- Question: Can this exception be justified for any unregulated and competitive services? Potentially this exemption would include contestable services (like contestable metering) offered by a DNSP. The concern is the DNSP's knowledge will advantage the provision of the competitive service

Issue 8 – Emergency response

- Draft Guideline – did not consider
- Submissions:
    - Services to other NSPs in emergencies should be regarded as unregulated distribution services
    - Exception for force majeure

- Question: Should we and if so how extensive should ring fencing exemptions be given to DNSPs in emergency response situations?

Issue 9 – Non-discrimination effect on DNSP purchasing

- Draft Guideline – 4.1(a) there is a broad obligation on DNSPs to not discriminate in favour of an affiliate.
- Submissions:
  - Suggests the AER is trying to force DNSPs to go to open tender rather use related parties or to otherwise influence purchasing policies
- Question: Doesn’t every DNSP already have in place policies and procedures to ensure value for money when purchasing decisions are made? If so, how would this provision adversely affect a DNSP?

Issue 10 – Transition to compliance

- Draft Guideline – we proposed 12 months to achieve compliance with respect to 3.1(a) (legal separation) and 6 months with respect to 4.2 (staff and office separation)
- Submissions:
  - Accept there is some need for transition but this should be kept to a minimum
  - Need more time – for example lease commitments
  - Suggest 18 months to comply
  - Branding changes can only occur after legal separation
  - Needs to be more flexible
  - Complex corporate restructuring needed
  - More transitions needed if AER revokes waivers or changes classification
- Question: How do we give DNSPs time to implement the new Guideline but not create a window for opportunism?

Issue 11 – Waivers

- Draft – waiver can only be applied for in regard to physical separation and staff sharing. Assessed against the NEO.
- Submissions:
  - Waivers undermine ring fencing
  - AER should publish criteria on how waivers will be assessed
  - There should be waivers available for all obligations – not just some
  - There should be no waivers at all
  - Waivers should be for fixed period only
  - AER should always consult – process not clear
  - Waivers should be offered in very limited circumstances
  - Waivers applications should be decided within a fixed period
  - No grandfathering
- Questions: How do we get the balance right? What is in the long term interest of consumers?

Issue 12 – Compliance

- Draft Guideline – A annual compliance report to be submitted by DNSPs. DNSP must notify breaches within 5 business days.
- Submissions:
  - Extend 5 days to 20 days for notification of breaches
  - DNSP appointed auditors should be changed from time to time
  - Guideline should provide more guidance on how to comply
  - AER should report annually on ring fencing compliance
  - Fines should be applicable to breaches
  - AER monitoring and enforcement measures unclear
  - AER should be proactive
  - Link to AER compliance guideline for retail and gas
- Questions: What level of monitoring, enforcement and reporting is required to provide market confidence? How do we do this without imposing excessive costs that will ultimately be met by consumers?

Issue 13 – other issues

- The Guideline should treat large customers differently to small customers (risk of harm is not the same)
- The Guideline should explain the treatment of contractors and staff transfers across DNSP business units
- Will Ring-fencing compliance costs qualify as a pass through event
- Information protection and sharing provisions seem excessive given other obligation such as NER chapter 8

Next steps

- Exposure draft release early November
- Concise submissions a week later
- Final Guideline and Explanatory Statement by 1 December, 2016

- AER contact:
  - Ringfencingguideline2016@aer.gov.au