



Draft Decision

TasNetworks
Application for Waiver from Transmission
Ring-fencing Guidelines

March 2014

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Shortened forms

Shortened form	Extended form
ACCC	Australian Competition and Consumer Commission
Aurora	Aurora Energy Pty Ltd
AER	Australian Energy Regulator
DNSP	Distribution Network Service Provider
Guidelines	Australian Competition and Consumer Commission, <i>Transmission Ring-Fencing Guidelines</i> , August 2002
NEL	National Electricity Law
NER	National Electricity Rules
TasNetworks	Tasmanian Networks Pty Ltd
TNSP	Transmission Network Service Provider
Transend	Transend Networks Pty Ltd

Request for submissions

The Australian Energy Regulator (AER) has made its draft decision on TasNetworks' application for a waiver of obligations under clause 7.1(a)(ii) of the *Transmission Ring-Fencing Guidelines*, August 2002 (Guidelines). TasNetworks is a new State owned company which will manage the transmission and distribution of electricity in Tasmania from 1 July 2014. TasNetworks is seeking a waiver of clause 7.1(a)(ii) of the Guidelines which would otherwise prevent a TNSP from carrying on the activity of distribution. TasNetworks is seeking a waiver of the obligations set out in clause 7.1(a)(ii) of the Guidelines on the basis that the cost of complying with the obligations outweighs the benefit, or likely benefit, to the public of compliance.

Interested parties are invited to make written submissions on this draft decision to the AER by the close of business on Wednesday, 9 April 2014. Submissions can be sent electronically to AERInquiry@aer.gov.au.

Alternatively, submissions can be mailed to:

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The AER will consider all information it receives in accordance with the ACCC/AER information policy. The policy is available at www.aer.gov.au.

The AER prefers that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information are requested to:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission.

All non-confidential submissions will be placed on the AER website. Copies of TasNetworks' waiver application and other relevant material are available on the AER's website.

Enquiries about this draft decision, or about lodging submissions, can be made by email to AERInquiry@aer.gov.au.

Summary

On 5 February 2014, TasNetworks applied to the AER for a waiver from the ring-fencing obligations set out in clause 7.1(a)(ii) of the Guidelines. Clause 7.1(a)(ii) of the Guidelines provides that a TNSP must not carry on a *related business*, which is defined as the activities of generation, distribution and electricity retail supply.

TasNetworks' waiver application, if granted, would allow TasNetworks to own and operate both the transmission business currently operated by Transend and the distribution business operated by Aurora. The integration of the two Tasmanian network businesses is one of a number of reforms to the Tasmanian electricity supply industry announced by the Tasmanian Government on 15 May 2012.¹

Under clause 11 of the Guidelines, the AER may waive any of the obligations under clause 7 provided that it is satisfied that the benefit, or any likely benefit, to the public is outweighed by the administrative cost of complying with the obligation. Having considered TasNetworks' application, we have made a draft decision to waive TasNetworks' requirement to comply with clause 7.1(a)(ii) of the Guidelines. We consider that the benefit, or likely benefit, to the public of compliance is outweighed by the administrative cost to TasNetworks of complying with the ring-fencing obligation.

¹ Tasmanian Minister for Energy and Resources, Ministerial Statement, *Energy for the Future*, 15 May 2012, p. 6.

1 Transmission Ring-fencing Guidelines

The ACCC published the Guidelines in August 2002.² The Guidelines separate the accounting and functional aspects of ring-fenced services from other services provided by TNSPs. The objective of the Guidelines is to separate as far as possible the monopoly powers of TNSPs from the contestable activities of generation and retail supply.³ In establishing the Guidelines, the ACCC retained the flexibility to waive elements of the ring-fencing arrangements where the costs of compliance outweigh the benefits.

The AER assumed the ACCC's responsibilities for the economic regulation of TNSPs in the NEM from 1 July 2005. Clause 6A.21.1 of the NER obliges TNSPs to comply with the Guidelines. Ring-fencing obligations under the Guidelines include the requirement that a TNSP:

- not carry on a related business
- not act in a manner that discriminates in favour of an associate
- maintain a separate set of accounts for its ring-fenced services and consolidated accounts for its entire business
- allocate any shared costs between ring-fenced services and any other activity in accordance with any guidelines published or approved by the ACCC
- ensure that preferential treatment is not given to an associate that takes part in a related business through sharing of operational activities.

1.1 Procedure for waiving ring-fencing obligations

Clause 7 of the Guidelines sets out the minimum ring-fencing obligations imposed on TNSPs. A TNSP may seek a waiver from these obligations under section 11 of the Guidelines. Section 11 states:

The ACCC may, by notice to the TNSP, waive any of the TNSP's obligations under clause 7 provided that the ACCC is satisfied that the benefit, or any likely benefit, to the public is outweighed by the administrative cost to the TNSP and its associates of complying with the obligation.

Note: In deciding whether to waive any of the TNSP's obligations under clause 7, the ACCC may consider any additional obligations that can be imposed under clause 9.

Where a TNSP applies for a waiver from requirements of the Guidelines, we must follow the consultation procedure set out in section 17 of the Guidelines in assessing the application. The table below sets out this procedure.

² ACCC, *Statement of Principles for the Regulation of Transmission Revenues: Transmission Ring-Fencing Guidelines*, 15 August 2002.

³ ACCC, *Statement of Principles for the Regulation of Transmission Revenues: Transmission Ring-Fencing Guidelines*, 15 August 2002, pp. 1-2.

Table 1: Timetable for assessing TasNetworks' waiver application

Event	Date
Waiver application received from TasNetworks	5 February 2014
Notice of application released	7 February 2014
Submissions on application due	3 March 2014
AER's draft decision released	21 March 2014
Submissions on the draft decision due	9 April 2014
AER's final decision released	12 May 2014

On 7 February 2014, we published TasNetworks' waiver application and sought submissions from interested parties. No submissions were received.

2 TasNetworks' waiver application

On 5 February 2014, TasNetworks applied to the AER for a waiver from the ring-fencing Guidelines requirement that a TNSP not carry on a related business. A 'related business' is defined in section 4 of the Guidelines as the activities of generation, distribution and electricity retail supply. TasNetworks is seeking a waiver of these obligations in relation to the integration of Transend's transmission business and Aurora's distribution business under TasNetworks.

TasNetworks submitted that the cost of complying with the obligations imposed by clause 7.1(a)(ii) of the Guideline, which would require the maintenance of two separate businesses, far outweighs the negligible public benefit, or likely benefit, of compliance in the Tasmanian jurisdiction. TasNetworks stated that the aim of the Guideline is to separate the monopoly powers and functions of a TNSP from contestable activities, particularly in the generation and retail supply sectors rather than the monopoly powers and functions of network businesses.⁴

2.1 Public benefit of ring-fencing obligations

TasNetworks addressed the potential benefits of full separation of transmission and distribution businesses previously identified by the ACCC.⁵ These benefits relate to reducing a TNSP's ability to:

- discriminate in favour of, or give preferential treatment to, a related business
- share confidential information with a related business
- shift costs within the integrated businesses.

2.1.1 Discrimination in favour and preferential treatment of a related business

TasNetworks submitted that in respect to the provision of contestable services, there is little scope for competition between Transend's transmission business and Aurora's distribution business. The clearly defined electrical functions and capabilities of each network generally means that a customer service could only practically be performed by one network or the other. Further, TasNetworks stated that a waiver of clause 7.2(b) of the Guidelines is not being sought, so the application will not affect the public benefit arising from protection against the risk of discrimination in favour of itself.⁶

2.1.2 Share confidential information with a related business

TasNetworks submitted that a waiver of clause 7.1(a)(ii) of the Guidelines would not alter existing obligations in relation to the sharing of information. The existing information provision obligations under the NER, the NEL and jurisdictional regulatory regimes would still apply to a DNSP and TNSP that are part of an integrated business. TasNetworks also submitted that the *Tasmanian Electricity Reform Act 2012* will preserve all existing contractual arrangements, rights and liabilities of the separate businesses when transferred to the new integrated entity.

TasNetworks stated that although information systems within the business will be shared, appropriate access restrictions will be imposed.⁷

⁴ TasNetworks, *Transmission Ring Fencing Guidelines Waiver Application*, 5 February 2014, pp. 4-5.

⁵ ACCC, Draft Decision, *SPI PowerNet Application for Waiver of Ring-fencing Arrangements*, 15 December 2004, p. 9.

⁶ Clause 7.2(b) of the Guideline stipulates that a TNSP that provides ring-fenced services must offer those services to its customers on terms and conditions no less favourable than it provides to itself or its associates.

⁷ TasNetworks, *Transmission Ring Fencing Guidelines Waiver Application*, 5 February 2014, p. 6.

2.1.3 Cost shifting within the integrated business

TasNetworks submitted that it will maintain accounting separation of its transmission and distribution businesses. The requirement to maintain separate regulatory accounts is necessary to maintain compliance with chapter 6 and 6A of the NER and because both businesses are operating within different revenue settings, pricing rules and incentive arrangements.

TasNetworks submitted that regulatory accounting separation will assist in reducing opportunities for cost shifting. TasNetworks will have in place procedures that will enable the appropriate identification and allocation of costs in accordance with the NER and associated AER guidelines and approved cost allocation methodologies.⁸

2.2 Administrative cost of ring-fencing

TasNetworks has identified a number of administrative costs that would be incurred in order to comply with clause 7.1(a)(ii) of the Guidelines. Duplicate functions identified by TasNetworks include:

- corporate services - administrative support, human resource management, legal services, information technology, finance and office accommodation
- governance, risk and compliance systems
- personnel for common support and operations functions.

TasNetworks also submitted that administrative costs are incurred because of the separation of assets and skilled employees that could otherwise be shared instead of each business outsourcing these services to a commercial provider.

TasNetworks quantified the administrative costs arising from compliance with the ring-fencing obligations in clause 7.1(a)(ii) of the Guidelines in the order of \$2.4 million to \$5.6 million per annum. This estimate of administrative costs was made as part of the 2012 review of Tasmania's electricity supply industry, which identified potential savings from the integration of the network businesses.⁹

TasNetworks submitted that there may be further scope for cost savings beyond that identified by the review, however, at this stage detailed analysis for an optimum organisational structure for TasNetworks and the streamlining of support processes and systems has not yet been completed.

2.3 Loss of economies of scale

In addition, TasNetworks submitted that segregated distribution and transmission businesses have less ability to negotiate in the marketplace than a larger corporate entity. This imposes costs in the form of higher contract prices for goods and services.

⁸ TasNetworks, *Transmission Ring Fencing Guidelines Waiver Application*, 5 February 2014, pp. 6-7.

⁹ Electricity Supply Industry Expert Panel, *Draft Report - An Independent Assessment of the Tasmanian Electricity Supply Industry*, December 2011, p. 264.

3 AER's assessment

Section 11 of the Guidelines provides that the AER may waive any of a TNSP's ring-fencing obligations under section 7 if it is satisfied that the benefit, or any likely benefit, to the public is outweighed by the administrative cost to the TNSP and its associates of complying with the obligation.

3.1 AER's considerations

We accept TasNetworks' submission that the administrative cost of complying with the obligations under clause 7.1(a)(ii) of the Guidelines outweighs the public benefit of compliance in respect of the integration of the transmission and distribution businesses in Tasmania.

As a general rule, we consider the requirement of legal separation as a necessary aspect of the regulation of network businesses. It is particularly important for the effective separation of any upstream and downstream business activities from monopoly businesses, and the elimination of cross-subsidies and incentives to undertake anti-competitive behaviour.

However, we accept that TasNetworks will incur administrative costs in complying with section 7.1(a)(ii) of the Guidelines. These costs are potentially significant and would be reflected in transmission and distribution tariffs. The public benefit of compliance is minimal, particularly given that other ring-fencing arrangements will remain in place.

The matters considered by the AER and the reasons for our draft decision are set out below.

3.1.1 Test for waiver of ring-fencing obligations

The test under section 11 of the Guidelines requires us to assess:

- the public benefits of compliance with the obligations in the Guidelines
- the administrative costs of compliance with the obligations in the Guidelines.

If we are satisfied the administrative cost outweighs the public benefit, the waiver should be granted.

3.1.2 Public benefit of compliance with clause 7.1(a)(ii)

We consider that the public benefit of maintaining the ring-fencing requirements of clause 7.1(a)(ii) of the Guidelines is minimal in this case. The waiver will not affect other existing obligations on the TNSP and DNSP businesses which protect the interests of consumers, such as the regulatory accounting regime and restrictions on preferential dealing and sharing confidential information.

The ACCC has previously identified the key potential benefits to the full separation of transmission and distribution businesses as reducing the TNSP's opportunity to:¹⁰

- discriminate in favour of a related business
- give preferential treatment to a related business
- share confidential information with a related business
- shift costs within the integrated business.

¹⁰ ACCC, Draft Decision, *SPI PowerNet Application for Waiver of Ring-fencing Arrangements*, 15 December 2004, p. 9.

TasNetworks addressed each of these points in its waiver application.¹¹

We consider there is little scope for TasNetworks' transmission business to give preferential treatment or discriminate in favour of the distribution business. Firstly, unlike some larger jurisdictions, Aurora is currently the only distribution business operating in Tasmania. Situations in which a TNSP might discriminate in favour of an affiliated distribution business, such as through prioritising supply restoration following an unplanned outage, are therefore unlikely to arise. In any case, the waiver sought by TasNetworks does not affect the operation of clause 7.2(b) of the Guidelines, which is intended to ensure that a TNSP does not preferentially deal with itself or its associates.

In relation to the sharing of confidential information between businesses, we are satisfied that the confidential information provision obligations under the NER, NEL and jurisdictional regulatory regimes that apply to separate transmission and distribution businesses would still apply to an integrated network business. TasNetworks has advised that it will maintain appropriate access restrictions to the shared information systems of the transmission and distribution businesses. Further, the *Tasmanian Electricity Reform Act 2012* will preserve all existing contractual arrangements, rights and liabilities of the separate businesses when transferred to the new integrated entity.

Chapters 6 and 6A of the NER will require TasNetworks to maintain separate regulatory accounts for its transmission and distribution businesses. TasNetworks must continue to identify and allocate costs in accordance with the NER and the approved cost allocation methodologies for the distribution and transmission businesses. These regulatory accounting obligations will reduce opportunities for cost shifting between the two businesses. We consider these ongoing arrangements adequately address the issue of cost shifting, such that any loss of public benefit arising from granting the waiver is minimal.

The effect of a waiver of clause 7.1(a)(ii) which allows a TNSP to carry on both a transmission and distribution business is that the TNSP may no longer have an associate carrying on a related business for the purposes of section 7 on the Guidelines. As a consequence, clauses 7.6, 7.7 and 7.8 of the Guidelines which govern the relationship between a TNSP and an associate carrying on a related business will cease to have effect. We have therefore considered the public benefit associated with these clauses in assessing TasNetworks waiver application.

Clauses 7.6, 7.7 and 7.8 relate to the preferential treatment of associates, the separation of marketing staff between TNSPs and associates, and notification requirements for staff movements between TNSPs and associates. Having considered the effect of these clauses, we consider that the public benefit associated with the ongoing application of these clauses is minimal, for the following reasons:

- the public benefit provided by preventing the preferential treatment of associates under clause 7.6 will continue to be provided by clause 7.2(b), which ensures that a TNSP does not preferentially deal with itself. The risks associated with anti-competitive behaviour in these circumstances is, in any case, low given there is only one distribution business in Tasmania
- the separation of marketing and other staff of TNSPs and associates may provide benefits in ensuring effective separation of monopoly businesses from competitive generation or retail activities, but is unlikely to do so in the context of two monopoly network businesses.

¹¹ TasNetworks, *Transmission Ring Fencing Guidelines Waiver Application*, 5 February 2014, pp. 5-7.

3.1.3 Administrative costs of compliance with clause 7.1(a)(ii)

The ring-fencing obligations set out in clause 7.1(a)(ii) of the Guidelines would impose administrative costs on TasNetworks. In the absence of a waiver of clause 7.1(a)(ii) of the Guidelines, TasNetworks would be required to maintain legally and operationally separate transmission and distribution businesses. This would impose a number of administrative costs in the form of duplicate functions, assets and staff. TasNetworks submitted that the administrative costs arising from compliance with the ring-fencing obligations in clause 7.1(a)(ii) of the Guidelines are in the order of \$2.4 million to \$5.6 million per annum.

Duplicate administrative costs would be incurred where similar corporate services are provided separately within each business. These services are likely to include administrative support, human resource management, legal services, information technology and office accommodation costs. Further direct administrative costs may be incurred in licencing and regulatory compliance, procurement and other administrative functions.

The quantum of administrative costs submitted by TasNetworks is based on an expert external review undertaken by Ernst & Young as part of the review of Tasmania's electricity supply industry.¹² We therefore consider that the costs identified by TasNetworks are based on reasonable estimates.

In addition to the costs identified by TasNetworks, in the absence of a waiver there are also likely to be ongoing compliance costs associated with clauses 7.6, 7.7 and 7.8 of the Guidelines. For example, the requirement of clause 7.8 for TasNetworks to notify the AER if any of its staff will also be staff of an associate that takes part in a related business is likely to be administratively onerous where a large number of staff are shared between the transmission and distribution businesses.

3.1.4 Conclusion

The ring-fencing obligations of clause 7.1(a)(ii) of the Guidelines will impose administrative costs on TasNetworks in the form of duplicate functions, assets and staff. These costs are likely to be in the order of \$2.4 million to \$5.6 million per annum. The public benefits lost as a result of waiving clause 7.1(a)(ii) are minimal, as other key regulatory obligations in the Guidelines and the NER will continue to apply.

We are satisfied that the administrative costs of compliance with clause 7.1(a)(ii) of the Guidelines will outweigh the public benefits of compliance. We therefore propose to grant a waiver of clause 7.1(a)(ii) for TasNetworks. A waiver of clause 7.1(a)(ii) will also have the effect of making clauses 7.6, 7.7 and 7.8 of the Guidelines redundant.

3.2 AER's draft decision

We propose to issue a notice under section 11 of the Guidelines to waive TasNetworks' obligation to comply with clause 7.1(a)(ii).

We invite interested parties to make written submissions on this draft decision by close of business on 9 April 2014.

¹² Electricity Supply Industry Expert Panel, *Draft Report - An Independent Assessment of the Tasmanian Electricity Supply Industry*, December 2011, p. 264.