



Monday 14th August 2017

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

Re: Submission on Ring Fencing Guidelines

1 Background

- 1.1 These submissions are made by All Round Supplies (**ARS**). ARS is a supplier/distributor to Accredited Service Providers (**ASP's**) in NSW and electrical infrastructure contractors in other states with considerable experience as a distributor of utility materials, having worked with many utility networks throughout Australia (in particular NSW) over a long period of time.
- 1.2 These submissions relate to the review currently being undertaken by the Australian Energy Regulator (**AER**) with respect to the:
 - (1) Electricity Distribution Ring-Fencing Guideline (**Guideline**) which commenced on 1 June 2016 (as amended from time to time); and
 - (2) explanatory statement to the Guidelines dated November 2016 (**Statement**).
- 1.3 The intention of these submissions is to make the AER aware of an area of the Guidelines and the Statement that requires clarification. The clarification will assist to ensure that the stated objective of the Guidelines, to provide a level playing field for third party providers in new and existing markets for contestable services, is achieved.
- 1.4 ARS stresses that these submissions do not relate to the scope or intent of the Guidelines but are instead focused on improving clarity and therefore avoid any unintended consequences that may flow from how the Guidelines and the Statement are presently drafted.
- 1.5 In that regard, ARS believes that the Guidelines and the Statement, as they are presently drafted:
 - (1) increases the risk of distribution network services providers (**DNSPs**) cross-subsidising an affiliate's services in contestable markets with revenue or goods derived from its regulated services; and
 - (2) threatens the development of the competitive contestable market.

2 Measures targeted at cross-subsidisation

- 2.1 The Guideline seek to enforce DNSPs implementing the following in order to prevent cross-subsidisation:
 - (1) legal separation;
 - (2) separate accounting; and
 - (3) cost allocation.
- 2.2 The purpose of such measures is to help guarantee:
 - (1) business separation to mitigate the risk of cross-subsidies;

- (2) internal accounting procedures to demonstrate the nature and extent of transactions between affiliated entities; and
 - (3) preventing the allocation of costs or attribution to distribution services where those costs properly relate to other services.
- 2.3 The intention of these measures is to provide for the accounting and functional separation of the provision of direct control services from the provision of other services provided by DNSPs or their affiliated entities and to assist in achieving the overall objective of the Guidelines.

3 Goods and Services

- 3.1 The above measures, contained in clause 3 of the Guidelines, reference a number of different 'services' that can or cannot be provided by a DNSP. There is no reference in the Guidelines to those measures also applying to goods and materials provided by DNSPs or their affiliates.
- 3.2 However, ARS notes that the Guidelines specifically refer to services and goods as being subject to the Guidelines.
- 3.3 In particular, page 3 of the Statement refers to the accounting obligations and legal separation require a DNSP applying enter into "*separate transactions for goods or services*". While this is reflected in clause 4.1(a)(iii) (page 13) of the *Draft Amended Ring-Fencing Guideline – Electricity Distribution – July 2017*, it is not clear that the intention is that the Guidelines are intended to apply to both goods and services as a matter of course, and not just limited to that clause.
- 3.4 Further to the above, page 3 of the Statement notes that "*a DNSP must only provide distribution services*". As part of those services, a DNSP provides goods and materials in order to provide those services.
- 3.5 Accordingly, a DNSP provides goods and materials as part of the provision of services by it in the ordinary course of its operations. However, because a DNSP provides goods and materials as part of the provision of its services the term *services* when applied to a DNSP is used to describe its provision of both services and goods/materials.
- 3.6 ARS submits that the Statement, by its specific reference to goods, makes it clear that that the Guideline are intended to apply to both services and goods/materials provided by DNSPs and their affiliates, however, the term *services* alone is used on account of that term being generally used to describe the provision of goods and services by DNSPs.
- 3.7 However, there is no specific reference to goods or material in the Guidelines which ARS submits causes the Guidelines to be read so as to only apply to services and not to goods/materials. In that regard, the provision of goods and materials is a distinct and separate function of businesses and is not always considered to be a 'service' as a matter of course.
- 3.8 Accordingly, ARS requests that the Guidelines be amended so as to provide greater certainty and clarity that they apply to both services and goods/materials in the same way.
- 3.9 Failure to provide that clarity will result in DNPSs not complying with the Guidelines with respect to goods in the manner intended, and therefore the objectives of the Guidelines not being achieved in a significant area of contestable services.

4 Examples illustrating the need for clarification

- 4.1 The following are examples, for the AER's consideration, of why the Guidelines should be clarified as set out above:
- (1) DNSPs have well established procurement and logistic infrastructure which supports their monopoly activity of capital, maintenance and breakdown works. This allows DNSPs to obtain competitive pricing due to the volume of material that they purchase.

This advantage heightens the chance of cross-subsidisation by way of DNSPs on-selling these materials to affiliated entities at cheaper prices than what ASPs can purchase materials for.

- (2) DNSPs hold a significant level of stock to support their monopoly activities. This availability of stock and significant purchasing power places DNSP affiliates at an advantage over ASPs in the contestable business market as ASPs have significant wait times for the delivery of certain stock.
- (3) DNSPs have significant influence over the approval process of materials, and consequently the suppliers of materials, which has significant impact on the provision of materials in the contestable business market.

4.2 ARS believes that if the Guideline and Statement are not clarified to expressly refer to the Guideline's application to the provision of goods in addition to services, such anti-competitive conduct could be engaged in by DNSPs. This is because DNSPs may believe that accounting and functional separation is not required between the supply of goods relating to their direct control services and the supply of goods relating to the contestable market and the DNSPs affiliated entities.

5 Concluding comments

I would be happy to discuss any aspect of the above with you, otherwise I look forward to the Guidelines being amended so as to clarify the matters referred to above.

Yours faithfully



Earl Palfrey
Managing Director