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Dear Mr Pattas

Thank you for the opportunity to respond to the *Distribution and transmission confidentiality guidelines, Issues paper* (Issues Paper) published by the Australian Energy Regulator (AER) in March 2013.

The Issues Paper raises important questions about the current approach to the making and management of confidentiality claims by the Network Service Providers (NSPs). The NSPs' confidentiality claims cover information that is important to stakeholders in assessing the performance and efficiency of NSPs. They are, therefore, a significant barrier to transparency and participation by consumers in the regulatory processes.

While NSPs vary in the extent to which they claim confidentiality over material provided in their various regulatory documents, the evidence provided in the AER's Issues Paper indicates that it is a substantial and growing problem; up to 88 per cent in one instance cited by the AER.

Whether that is because NSPs find it easier to make blanket claims over whole documents or sections of their submissions, or because they want to minimize public scrutiny and participation, is not clear. What is clear is that various stakeholders have expressed growing frustration over the impact of this trend on their ability to partake in the regulatory processes including participation in the Australian Competition Tribunal appeal process.

The establishment of a Confidentiality Guideline (the Guideline) is, therefore, an important step to moving the regulation of the monopoly network businesses towards the objectives set out in the Better Regulation program. This includes moving towards more collaborative processes that will, in turn, reduce the need for the AER to use its mandatory disclosure powers under the National Electricity Law (NEL)[1] and enhance the meaningful engagement of consumers in the regulatory process.

While the AER proposes many sensible solutions to the current excessive use of confidentiality claims, there appears to be one area that is poorly addressed in the Issues Paper. This is the treatment of confidentiality claims over third party provider costs.

As NSPs make increasing use of third party providers to provide both capital and operating cost services, the use of Confidentiality claims to restrict information on these costs is also a matter of increasing concern to stakeholders. It has the potential to limit stakeholder participation in the process

[1] NEL, s 28ZB.
[2] NER, cl 6.14A(d) & cl 6A.16A(d). Other Guidelines are non-mandatory.

and may even impact on the ability of the AER to use benchmarking and incentives in an open and transparent way.

The following comments on specific issues raised by the in the Issues Paper are made against this background.

How widely should the Guideline apply?

An important distinguishing feature of the Guideline is that the Guideline will be binding on the AER and on each of the NSPs to which they apply.[2]

The AER is also proposing that the reach of the Guideline is quite extensive, that is, it applies to an NSP's regulatory proposal, revenue proposal or proposed pricing methodology (including any revisions to these proposals and methodologies), regulatory information notices and information requests.

In addition, the AER is proposing a single set of guidelines covering both electricity distribution NSPs (DNSPs) and electricity transmission NSPs (TNSPs). The AER suggests that it is also seeking to apply the policy to all information received from gas service providers.

This broad reach is a sound approach. The underlying policy principle of maximizing transparency in the regulation of monopoly businesses is reflected not only in the NEL and NER and the National Gas Law (NGL) and National Gas Rules (NGR). Similarly, the emerging policy principles of enhanced consumer engagement in processes and outcomes requires a much greater level of transparency around the information that underpins the regulatory decision making.

However, given that the Guideline will be both mandatory and covering a broad scope, the Guideline should also be relatively high-level, setting out the process for making a confidentiality claim, the categories of information that would generally be regarded as public or confidential (as the case may be) and the AER's approach to managing information.

Adopting a high-level approach provides the opportunity for the AER to customize the detailed application of the processes to the circumstances of each sector of the industry – a flexibility that is important, but must still be deeply rooted in the principles of transparency.

How should NSPs make confidentiality claims?

The AER is proposing a template for NSPs to use when making confidentiality claims.

The template approach will force NSPs to be much more transparent and specific about their confidentiality claims by, for instance, providing page and paragraph numbers and clearly indicating where information has been redacted along with the NSP's reasons for doing so in each instance.

In addition, the AER proposes that the NSPs provide details of how many and what proportion of pages, in total, is subject to a confidentiality claim.

The requirement to be specific about the sections of the proposals that are subject to a confidentiality claim and provide reasons for each claim is itself an effective way of driving greater transparency. It should simultaneously reduce the amount of information subject to the claim, and provide more clarity

[2] NER, cl 6.14A(d) & cl 6A.16A(d). Other Guidelines are non-mandatory.

on the specific types of information removed. This will assist the AER and, more particularly, stakeholders in evaluating the significance of the claims and their merit.

The AER's proposals *may initially* add to the administration requirements on the NSPs and the AER. For instance, the AER states in the Issues Paper, '*we are aware that our proposed approach may increase NSP's compliance costs*'.[3]

This *may* be the case. However, the claim of increased costs should not go unchallenged, particularly if this cost is past through to consumers in regulated charges.

The principles of transparency and limited use of confidentiality claims are implicit in the NER and the NEL, which require an NSP to demonstrate that the detriment to the NSP of disclosure outweighs the a public benefit.[4] The fact that the Guidelines will enforce this obligation that (some would argue) has been regularly flouted to date, should *not* lead to additional cost claims by the NSP.

Moreover, the requirement for specific referencing is likely to discourage over-use of the confidentiality claims as suggested above. Those NSPs who have previously made more than 60 per cent of their submissions confidential may find the new obligation ultimately reduces their work by screening out claims that are not necessary and/or reducing the number of claims that are subject to disclosure orders by the AER under s 28ZB of the NEL.

The second leg of the AER's proposal, for publishing a notice of the number of pages subject to confidentiality claim, is of less immediate relevance to stakeholders as it provides no indication of the relative importance of different information to the final outcomes of the determination process.

However, given that the AER is obliged to publish this information under the Rules,[5] then the AER's view that the NSPs should calculate the proportion of the documents subject to the confidentiality claim is quite appropriate. Again, this is putting accountability for the claims and the implications of these choices with the NSP.

For it to be meaningful, however, the AER will require some form of verification of these percentages.

What information that should be protected or disclosed?

The AER states that it already conducts a process by which it seeks to work with the NSPs in a 'collaborative fashion' to clarify how and on what basis a claim of confidential information might be made or not made (as the case may be).[6]

Moreover, where the collaborative approach fails to 'resolve' a confidentiality issue with an NSP, the AER has been able to use its significant powers under section 28ZB of the NEL to (for example) issue a disclosure notice stating (inter alia) its intention to disclose information and why, in the view of the AER, the disclosure will not cause 'detriment' to the NSP that outweighs the public benefit.

Before considering the proposed confidentiality guidelines, therefore, it is important to fully address the question of why so much of the documents submitted to the AER in (for example) the Victorian

[3] AER, *Better Regulation, Distribution and transmission confidentiality guidelines, Issues paper*, March 2013, p 20.
[4] This is the test set out in NEL, s 28ZB(2) & s 28ZB (6) for the AER to apply before disclosing information that has been claimed to be confidential.
[5] NER, cl 6.9.2A(b) & cl 6A.11.2A(b).
[6] AER Issues Paper, n 3, p 13.

electricity distribution were still successfully covered by confidentiality claims (ranging from 55 per cent to 88 percent for three Victorian NSPs [7], including one initial regulatory proposal where almost 23,000 pages were subject to confidentiality claims).

The AER states in the Issues Paper that the sheer volume of the confidentiality claims, which in many cases covered whole documents, '*made it difficult for the AER to apply its formal information disclosure powers …'*[8]

This is clearly a major issue given the regulatory intent of the NEL and the NER and, therefore, one that the mandatory confidentiality guidelines must address vigorously.

It is almost impossible to imagine that 60 per cent or more of the activities of a regulated monopoly business satisfy the confidentiality test, that is, publication of the information would cause the NSP a level of detriment that outweighs the public benefit of its publication.

Given the extent of the problem with confidentiality claims and the risk that this may increase in the future if not strongly addressed at this time, the *starting position* in the Guidelines should be a default presumption that *all information* should be disclosed as part of the 'regulatory contract' between NSPs, the AER and consumers.

From that starting point, the debate can then move on to what categories of information might (under specified circumstances) be exempted from the default position, that is, could reasonably be the subject of a confidentiality claim based on the level of detriment versus the public benefit of disclosure.

In the Issues Paper, the AER has provided a list of 5 categories of information it is considering protecting.[9] However, this requires some further analysis, particularly if their inclusion in the Guideline leads to a presumption by the NSPs that all these 5 categories of information would be *automatically* subject to and protected by confidentiality claims.

Using the test of detriment versus public benefit, only 2 of the categories are clearly in the camp of information that should be *generally* deemed confidential (although the AER should retain discretion over this too, to ensure that they are not 'exploited' by the NSPs as reasons in the future).

These are firstly, protecting information that might impact on the security of the network and, secondly, protecting personal information.

Protection of information in the remaining 3 categories of information in the AER's list requires further investigation.

For example, these items include information on supplier costs, internal labour costs and more generally, information that '*would affect the NSP's ability to obtain competitive prices in future infrastructure transactions*', or strategic information '*where release of the information might adversely impact the NSPs ability to negotiate a fair market price*.'[10]

These categories are subjective and there should be no presumption that the detriment to the NSP outweighs the benefit of disclosures.

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[7] AER, Issues Paper, n 3, Table 1, p 11. Proportion cited in the text above is based on the regulatory proposal and revised regulatory proposal, excluding spreadsheets, AER and AEMC documents that are publically available.
[8] AER, Issues Paper, n 3, p 11.
[9] AER, Issues Paper, n 3, p 16-17.
[10] AER, Issues Paper, n 3, p 16 – 17.

In addition, such broad categories could be used by NSPs to continue to make confidentiality claims across a wide range of important information, particularly as the use of external suppliers increases (see discussion below on third party costs). In turn, the AER would be forced to continue to rely on the powers under s 28ZB of the NEL, powers that have already proved inadequate *in practice* to efficiently and effectively addressing the problem.

All other categories of information, including (but not only) the types of information listed by the AER on page 17 of the Issues Paper, should be regarded as subject to the presumed to be non-confidential. Again, it would then be up to the NSP to substantiate the detriment to their business of disclosing the relevant information tested against the public interest in disclosure for each particular claim.

While noting the default assumption, it may be worth specifically highlighting (for the avoidance of doubt) that information on related party transactions and non-regulated activities using the regulated assets and resources should be disclosed unless net detriment can be demonstrated by the NSP.

Importantly, and as suggested by the AER, 'embarrassment' should not be one of the reasons for non-disclosure.

How should the AER deal with 'blanket' confidentiality claims?

The AER is proposing to take a firm stance against accepting blanket confidentiality claims by the NSPs and is, instead, proposing that the NSPs provide reasons for their confidentiality claims for each relevant section of each document.

This firmer approach by the AER is to be commended, as are the more proactive responses by some NSPs to limit their confidentiality claims. [11]

Should third party documents be protected?

The AER proposes treating third party documents, such as consultant and auditor reports, in the same manner as blanket confidentiality claims and placing a responsibility on the NSPs to verify third parties' confidentiality claims.

From a stakeholder's perspective, these documents are often important elements of an NSP's 'case' in a regulatory determination and in subsequent appeals to the Australian Competition Tribunal (the Tribunal). They can therefore also be quite fundamental to consumers' understanding and ability to constructively challenge any regulatory proposal or appeal to the Tribunal.

Moreover, it is difficult to see why the supplier, or the NSP, should in practice consider such documents confidential. For instance, if the provider has a conflict of interest, then consumers are entitled to know that as part of understanding the position taken.

For these reasons, the AER's proposed approach is supported.

An NSP can also be *proactive* in this area to avoid such situations arising. For instance, when tendering for consultancy or other services the NSP can make it clear that the services would be provided on the basis that all the information would be made public, unless a clear case can be made by *both* the supplier and the NSP that there is a detriment to them that outweighs the public benefit test as defined under the NEL and the Guidelines.

[11] AER, Issues Paper, n 3, p 18.

If suppliers are clear about this obligation on the NSP at the start of the contract, then they can choose how and on what basis they provide the services to the NSP.

Should third party supplier costs be protected?

The Issues Paper provides limited discussion on this issue, other than to suggest that 'supplier prices' are one of the items that the AER is considering protecting.[12]

However, it is most important for the AER to provide further clarification on what and how confidentiality claims will be managed in these areas. As noted above, it would, for instance, be of concern if supplier costs were automatically assessed as confidential information.

Third party service providers provide a significant percentage of capital and operating services to the NSPs.[13] These services, in turn, have frequently been provided under long-term recurrent contractual arrangements between the vendor and the NSP and cover a broad range of capital and operating activities, rather than individual tenders for a specific services.

For example, the 2011/12 Annual Report by Tenix, a leading infrastructure service provider, states: [14]

> With the successful commencement of the United Energy services contract mid-year we added another important and recurrent revenue stream to our networks services business. This importantly builds on our existing client base in this area including SP AusNet, ElectraNet and Ergon Energy. Although there is political and regulatory pressure on energy networks spending, we are encountering strong demand and may see more opportunity due to increased outsourcing by the state-owned networks.

There is no dispute that these types of arrangements have the *potentia*l to provide more efficient services to the network businesses and thereby benefit consumers. However, they also raise a number of difficulties for the regulator and for consumers in assessing whether the NSP is operating at an efficient cost level. These include:

- Where a third party service provider is providing services to multiple NSPs, it limits the opportunity for effective benchmarking of performance;

- Information on the costs of these services may be subject to 'confidentiality claims' by the service provider and/or the NSP; and

- The use of 'alliance style' agreements with third party service providers, particularly where these are 'pure alliance' agreements restrict insight into costs. In these types of contracts, the supplier may be selected on the basis of a qualitative assessment rather than through price competition, and the cost of the services supplied under the contract (the 'target outturn cost') is negotiated *after* the contract is agreed. In addition, the supplier and the NSP share the risks and benefits of under of over runs in expenditure against the target cost. [15]

[12] AER, Issues Paper, n 3, p 16.
[13] This percentage varies between NSPs, for instance, privately owned NSPs are (at this stage) more likely to outsource the majority of their capital and operating services to third parties or related parties. However, this may be changing (see quotation in the text above from Tenix).
[14] Tenix, *Annual Report 2012 Book 1*, p 9.
[15] For example, Tenix states in its 2012 Annual Report, n 14, at p 34, that its contract for electricity network maintenance and construction services with United Energy is based on an 'alliance style' agreement.

As noted by Tenix (above), the prevalence of third party contracting is likely to increase, as is the incidence of alliance style agreements where suppliers are selected on non-price criteria, and therefore lack transparency on efficient prices that would emerge from a tendering process that was based principally on price competitiveness.[16]

It is therefore important that the AER explicitly address the issue of third-party service pricing under standard and other forms of contracting (e.g. alliance contracts) in the Guidelines.[17]

For example, if the services to the NSP are largely provided under recurrent and long-term arrangements, it is then questionable whether the publication of third-party cost information during the course of an NSPs regulatory would 'affect the NSPs ability to obtain competitive prices in future infrastructure transactions, such as a tender process'.[18]

In addition, the NSPs can be more accountable for minimizing the likelihood of third party confidentiality claims, as they can build into their initial contract negotiations the fact that costs associated with the provision of regulated services may be published. It is then up to the third party to decide if they wish to proceed with the negotiations on that basis, or withdraw.

Again, thank you for the opportunity to comment on the proposed confidentiality guidelines.

Yours faithfully

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[16] A more detailed analysis of the risks and benefits of these types of contracts can be found (for example) in a report by John Paul Davies, *Alliance Contracts and Public Sector Governance,* August 2008.
[17] It may also be relevant as part of the consideration of Expenditure Assessment and Expenditure Incentives. For instance, what is the impact on the power of an incentive if the NSP is able to pass all or most of a cost increase onto a third another party?
[18] AER, Issues Paper, n 3, p 16.