Update to the Distribution Ring-fencing Guideline

Response to stakeholder workshop 28 & 29 August 2019

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Energy Networks Australia

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Key messages

- Distribution networks support appropriate ring-fencing and the important role it plays in preventing cross-subsidies and discriminatory behaviour.
- Independent assessors should be able to rely on the audit report of the financial statements in determining compliance with the cost allocation obligations in the Ring-fencing Guideline.
- Refining the definition of 'electricity information' will more appropriately identify staff that should not be shared between the network and an affiliated entity.
- Ring-fencing obligations should only be imposed where the benefits to competition outweigh the cost to consumers for implementing and maintaining the controls, particularly where measures are being implemented to address a perceived risk rather than actual harm.
- Customers must remain the focus of the Guideline – promoting a competitive market should not be to the detriment of the customer experience or outcome.

Overview

Energy Networks Australia is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia.

Energy Networks Australia welcomes the opportunity to provide a submission on potential changes to the 'Ring-fencing Guideline for Electricity Distribution Version 2' (the Guideline) and the associated 'Explanatory Statement' and 'Compliance Reporting Best Practice Manual version 2' (Best Practice Manual).

The AER's workshops held on 28 and 29 August 2019 highlighted that there is a need to clarify some aspects of the Guideline as networks have interpreted some terminology in different ways. Like all new regulations, some transitional 'teething problems' are to be expected and minor refinements, clarifications and improvements will ensure the intentions of the Guideline are adhered to in practice. In this regard, Energy Networks Australia expects to see a significant reduction in the number of breaches reported in the second round of annual compliance reporting.

The desire to create a competitive market must not outweigh the primacy of customer outcomes. The ultimate test must be the long-term interests of consumers, not simply the promotion of competition. In this regard, the introduction of the Guideline has not provided a positive experience for all customers. For example:

- Essential Energy has had to undertake extensive work with the AER to introduce a 'provider of last resort' scheme as the competitive market has failed to deliver for some customers deemed as being in competitive areas under the Guideline.
- To avoid unnecessary lengthy outages to NSW customers, the definition of 'Common distribution services' in the service classification for NSW distributors has had to be expanded to allow for simple rectifications on the customer side of the meter to be undertaken by the network.

- TasNetworks continues to grapple with sub-optimal customer outcomes arising from an under-developed competitive network.

Distribution networks are committed to meeting ring-fencing obligations and support the important role it plays in preventing cross-subsidies and discriminatory behaviour in the competitive market. Networks need to remain agile to capably and efficiently navigate the current energy transition. In this regard, Energy Networks Australia supports the Guideline remaining flexible with most of the proposed refinements likely sitting outside the Guideline document itself and instead in the associated Explanatory Statement and Best Practice Manual.

Cost allocation

The AER has raised concerns that where networks cost allocation methodologies (CAMs) do not operate across both **distribution services** and **non-distribution services**, many independent assessors of annual compliance reports have been relying on the audit review of the regulatory information notices (RINs) in forming their opinion as to the material accuracy of cost sharing between a network's **distribution services** and **non-distribution services** under clause 3.2.2(a).

Auditors commonly rely on the audit work of others in forming a review opinion. Such an approach is efficient as it avoids substantial rework and significantly lowers compliance costs, given the cost of a financial report audit is many hundreds of thousands of dollars.

Australian Auditing Standards require auditors to review and be satisfied as to the material accuracy of an entity's financial report and Australian businesses prepare their accounts in accordance with *Australian Accounting Standards* which prescribe how any costs are to be shared between entities within a group. The Annual RIN templates require the auditor to reconcile **distribution services** revenues and costs back to the audited statutory accounts. To do this, the auditor must necessarily review and assess the reasonableness of any cost allocations between the **distribution services** side of the business and the **non-distribution services** side of the business.

As such, Energy Networks Australia is of the view that independent assessors of the annual ring-fencing compliance report should be able to rely on the unqualified audit reports relating to the RIN audit where that audit has been undertaken using *Australian Auditing Standards* and the business prepares its statutory accounts in accordance with *Australian Accounting Standards*. Should the audit report be qualified, or the statutory accounts not prepared in accordance with *Australian Accounting Standards*, then Energy Networks Australia agrees that additional review by the independent assessor would be required. This approach more closely aligns with the remit of the AER to regulate **distribution services** under the National Electricity Rules.

Energy Networks Australia also agrees that if a summary as to how group costs are allocated between **distribution services** and **non-distribution services** is desired, then this should be made clear in the annual compliance reporting template. As mentioned above, the CAMs of some networks will cover this requirement. For others, who prepare their accounts in accordance with *Australian Accounting Standards*, a note to this effect would suffice.

Functional separation

It is important that the Guideline remains flexible to accommodate the expected growth in network data and changes in technology. However, just as the Guideline should not inadvertently impede innovation, it

should also not place undue regulatory burden on networks. In both these respects, Energy Networks Australia suggests some changes to the definitions section of the Guideline.

Definition of 'electricity information'

Energy Networks Australia agrees with the AER's suggestion that the current definition of **electricity information** is too broad. Many staff have access to 'information about electricity networks, electricity customers or electricity services' but only a subset of this information carries a potential commercial benefit and should be deemed 'sensitive'. In addition, far less staff have the 'opportunity to use' that **electricity information** to engage in conduct contrary to the ring-fencing obligations.

To appropriately recognise that not all 'information about electricity networks, electricity customers or electricity services' needs to be captured by the Guideline, Energy Networks Australia suggests that the current definition be split into two categories, **sensitive electricity information** and **non-sensitive electricity information**.

Proposed definitions, along with the types of network information they would comprise, can be found in *Appendix A -Proposed change to the definition of 'electricity information'.*

Definition of 'class of customer'

In addition, Energy Networks Australia believes that the term 'class of customer' needs to be defined to reduce the amount of aggregated data that is unnecessarily captured by the Guideline.

There are many ways that customers can be classed by networks, but many do not offer any commercial benefit if they are shared. For example, releasing aggregated data about the number of *residential* customers in an area offers no commercial or competitive benefit, but aggregated data indicating that there are 200 *solar customers* in that same area does offer a commercial benefit. Defining this term will help reduce undue regulatory burden on networks which can result in unnecessary cost impacts on customers.

A proposed definition can be found in *Appendix A – Proposed definition of 'class of customer'*.

Staff sharing

Identifying staff that may be shared

Using the proposed changes to the Guideline definitions above, only those staff with access to **sensitive electricity information** and the opportunity to use that **sensitive electricity information** to engage in conduct contrary to the Guideline obligations cannot be shared between the network and an **affiliated entity** and will also be required to be physically separated.

Due to the compressed timeline, networks have not undertaken a complete assessment of all roles against the revised definition, but an indicative approach is shown in *Appendix A – Staff sharing*

Secondments

Energy Networks Australia agrees that staff secondments that effectively allow employees, who have access to **sensitive electricity information** and the opportunity to use that **sensitive electricity information** to engage in conduct contrary to the Guideline obligations, to work part-time for both the network and an affiliate are contrary to the intention of the Guideline.

Such secondments would, however, be acceptable where staff do not have access to **sensitive electricity information** as ring-fencing issues are effectively managed through cost allocations. This flexible approach to working is becoming more common across the globe as businesses continue to strive for efficiency in the interest of keeping prices down for customers. It would not be in customer's best interests if the Guideline were to prohibit such efficiencies.

Procurement staff

Energy Networks Australia agrees that network's procurement staff with access to sensitive tender and pricing information (**sensitive electricity information**) should not also be involved in preparing tenders to the network business for **other electricity services** on behalf of an affiliate. In this respect, information barriers that prevent the procurement staff of an affiliate accessing the tender information of the regulated business are an appropriate control.

Such staff should not, however, be precluded from preparing tenders on behalf of the affiliate for the provision of other non-electricity services.

Office sharing

Energy Networks Australia believes that the current 'hard' obligations around physical separation of workspaces should include meeting rooms as 'work' is performed in those areas. However, extending the same separation to shared kitchen and bathroom facilities, simply to avoid the perceived risk of staff using information contrary to the guideline in the course of the working day, is excessive relative to the implied benefits that will be achieved.

The '*AER's Ring-fencing Guideline Preliminary Positions Paper*' (Preliminary Positions Paper) published in April 2016 raised two questions that must be answered to ensure the level of separation is efficient, effective and in the long-term interests of consumers:

1. What is the potential harm that ring-fencing is intended to address?
2. Do the benefits of ring-fencing outweigh the costs of compliance?[1]

The costs of ring-fencing compliance must be carefully weighed against the expected benefits. In this regard (emphasis added):

> *"…ring fencing structural obligations required by the regulator of the regulated entity should be flexible and dependent upon particular circumstances in the industry and* ***include a cost/benefit analysis of alternative arrangements with an assessment of the extent to which competition will be enhanced****[2]".*

In this regard, networks are not convinced that the AER has adequately assessed the extent by which competition is currently being harmed through the use of existing 'soft' controls, like staff training and operating procedures nor, more importantly, how competition will be enhanced under the proposed more onerous 'hard' physical separation controls. At this stage the proposal seems more about making

[1] *Electricity Ring-Fencing Guideline Preliminary positions*, AER, April 2016, p.14 https://www.aer.gov.au/system/files/AER%20ring%20fencing%20guideline%20-%20preliminary%20positions%20paper%20-%20April%202016.pdf

[2] *Information gathering for ring fencing and other regulatory purposes, Utility Regulators Forum discussion paper*, Chris Pattas, October 1999, p.vi

compliance checking easier and less about genuinely addressing a potential harm in a cost-effective manner in the long-term interests of consumers.

Given 'work' is not performed in either a kitchen or bathroom, the likelihood of **sensitive electricity information** being shared in these locations is no greater than in the office carpark or lift, or at any other social venue. It is also worth considering that even the 'hardest' of separation controls will never prevent an employee who, despite all the controls and training in place, chooses to use data in a manner contrary to the Guideline. This reinforces the need to balance customer costs and benefits in relation to the 'hard' separation controls proposed.

As the Preliminary Positions Paper indicated, the more onerous ring-fencing obligations are, the more costly they are to comply with[3]. Major plumbing and building works to install separate kitchen and bathroom facilities would entail a significant cost for some networks, especially when there may only be a handful of staff that require separation - such a circumstance may not be cost-effective and lead to the network pulling out from performing the function. This may lead to a worse customer outcome through a reduction in competition.

Networks believe that separating 'work' environments but allowing the sharing of (expensive to install) amenities like kitchens and bathrooms, when accompanied by appropriate 'soft' controls like staff-training and office procedures should be allowed under the Guideline. This more flexible and less costly approach to meeting the ring-fencing obligations better aligns with the benefits to consumers and the perceived enhancement to competition.

Information access and disclosure

Energy Networks Australia does not believe a breach of the Guideline has occurred just because affiliate staff have unintended access to **sensitive electricity information** of the regulated business. A breach only takes place if such staff actually access that information.

Unintended access is likely due to an oversight in system controls as networks transition to full compliance or the result of a temporary or accidental failure in controls. For example, a software upgrade may give rise to a small window of time where, technically, staff were able to access electricity information before access restrictions were reinstated.

Amending information technology (IT) systems to achieve full compliance is a long and ongoing process. For example, British Telecommunications has taken over 12 years to appropriately separate their IT systems following the agreement to functionally separate in 2006, and this has come at a significant cost to telephony consumers in Great Britain.[4]

If the contrary view is taken by the AER and even the potential for staff to access **sensitive electricity information** is considered to be a breach of the Guideline, then the interaction with pecuniary penalties will need to be considered.

- For example, a higher penalty should apply where **sensitive electricity information** is accessed compared to an instance where no access takes place.

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[3] *Electricity Ring-Fencing Guideline Preliminary positions*, AER, April 2016, p.26

[4] *Equality of Access Board, Annual Report 2018,* May 2018, p. 17. Available from: https://www.btplc.com/Thegroup/Ourcompany/Theboard/Boardcommittees/EqualityofAccessBoard/Publications/EAB_Annual_Report_2018.pdf

» Similarly, a 'no penalty' option may be required. For example, continuing the software upgrade example above, if the upgrade occurred overnight and the business also undertakes staff training around ring-fencing, then the business has done all it can physically do to reduce the risk of access occurring in the small window of time in which controls may not be fully operational.

Compliance Reporting

Template for networks annual compliance reporting

Energy Networks Australia supports the suggestion to update the Best Practice Manual to include a template for the AER's preferred long-form assessors report for reporting annual ring-fencing compliance.

This approach will provide consistency in network reporting. It should, therefore, also improve the efficiency of the AER's reporting as it will make it easier to locate and compare ring-fencing compliance between networks.

Material breaches

Energy Networks Australia agrees that the lack of definition around the word 'material' and the term 'something that is more than trivial' is leading to networks inconsistently reporting what the AER considers to be 'material' breaches within the five days required by the Guideline. The interpretation of 'material' will be significant if pecuniary penalties are to be applied to breaches of the Guideline.

Whilst the AER proposal to have all ring-fencing breaches reported in short-form to the AER within five business days and for the AER to then determine whether the breach is material offers a potential solution, Energy Networks Australia believes it will place unnecessary burden on both networks and the AER.

Reporting breaches to the AER is not a simple and quick process for networks. It requires a discussion with key staff to determine the high-level facts surrounding the breach. It can be difficult to gain time with all relevant staff in a short time period. On top of this, high level business sign-off is also required before the breach is notified to the AER. Again, this can be difficult to achieve in the five-day timeframe. As such, whilst a breach of some clauses within the Guideline will likely be material, breaches of many other clauses are unlikely to be so.

Rather than try and define the term 'material', which would likely be an impossible task given the breadth of clauses in the Guideline, Energy Networks Australia instead proposes that Energy Queensland's 'Materiality calculator' be adopted across all networks. It is our understanding that this assessment tool has been shared with the AER as Energy Queensland transitioned to operating under the Guideline.

Most of our distribution members have reviewed the 'Materiality calculator' and run a number of their reported breaches through the tool to determine whether the resulting assessment is reasonable. These networks have indicated that this tool and approach would enable them to assess and consider breaches in a consistent manner, though some networks have raised concerns as to the additional compliance costs the tool would give rise to.

For the AER's consideration, a copy of Energy Queensland's 'Materiality Calculator', Guiding Principles document and 'How to use' document are attached with this submission. These documents and calculator are, however, considered to be confidential and are labelled accordingly.

An alternative approach is for networks to only report network safety issues to the AER in the five-day timeframe and instead undertake quarterly reporting of ring-fencing breaches to the AER. This quarterly report would also outline the controls that were applied to stop each breach occurring again. Such an approach would reduce the burden of the current five-day reporting timeline and provide consistency with many other network reporting obligations.

Adjust the timing of annual compliance reporting

Move to calendar year reporting

Energy Networks Australia supports a suggested move for compliance reporting to be undertaken on a calendar year basis rather than a financial year basis. This will assist network's resourcing requirements by helping to spread the workload of many compliance teams who are already busy with RIN audits during September and October.

However, it is worth noting that such a move will necessarily require the independent assessor to be able to largely rely on the financial year audit in assessing cost allocations under the Guideline. It would be an expensive, unbudgeted cost if the AER were to expect another full audit of cost allocations six months after the last review. As mentioned in the *Cost allocation* section above, it is common practice to rely on previous audit work.

So, unless there has been a change to the CAM or *Australian Accounting Standards* that would have impacted costs in any way since the audit was last undertaken, Energy Networks Australia suggests that the independent assessor be allowed to rely on the previous audit findings in assessing compliance with the cost-allocations aspect of the Guideline.

In terms of transitioning to such a change, Energy Networks Australia suggests that networks' next annual compliance report cover an 18-month period from 1 July 2019 through to 31 December 2020, rather than the alternative of a report that covers just a six-month period to 31 December 2019. The cost of undertaking a second compliance review within the same financial year (for most businesses) will likely outweigh the relative benefits of a six-month reporting assessment. This is especially relevant given the AER's proposed Guideline changes and clarifications are expected to be released in early 2020. These refinements will improve consistency in network's interpretation and reporting and 're-set the bar' for associated compliance reporting.

Compliance reporting timeline

Energy Networks Australia does not, however, support the proposed adjustment to reduce the compliance reporting timeline from four months to three months.

As was mentioned at the workshops, staff leave over the Christmas and New Year period significantly impacts workplace efficiency. Whilst the AER currently bears the burden of this issue in preparing its Annual Compliance Report, networks are equally impacted. As such, when combined with a move to calendar year reporting, reducing the compliance reporting timeline by a month would effectively give networks just two months in which to prepare the report, have the independent assessment of compliance undertaken and obtain the necessary business sign-offs. This is not realistically achievable.

Moving to a three-month timeline, even if the ring-fencing compliance report remained on a financial year basis, is also unachievable for those networks that report on a financial-year basis. Such businesses are required to prepare and submit Statutory Accounts by 30 September and this is the main audit focus

until that time. Following the finalisation of the Statutory Accounts, the auditor then progresses to the RIN audits.

Given the RINs must be reconciled to the Statutory Accounts, if the ring-fencing compliance review was due to be submitted before the RIN audit was completed, then it is unlikely that the independent assessor would be able to determine the appropriateness of cost allocations under the Guideline.

Instead, given the proposed changes to have networks produce more consistent annual compliance reports (*Template for networks annual compliance reporting*) and more consistently report *Material breaches* to the AER, either within five business days using the 'Materiality calculator' or on a new quarterly basis, it is likely that the compilation, preparation and review of the AER's own Annual Compliance Report will be simpler and easier as time goes on.

Like all new reporting processes, the first round is always the hardest and takes the longest, however, incremental improvements and efficiencies are certainly expected over time, and especially in the first few years.

Branding

Energy Networks Australia does not agree that an **affiliated entity** and distribution network being linked under a shared parent name is a breach of the Guideline. The 'step-up' to a name that bears no resemblance to that of the network business or the **affiliated entity** is about marketing the group company name and, so long as there is no cross-promotion of both the network and **affiliated entity** name at the same time, seems entirely reasonable.

On a similar note, Energy Networks Australia continues to support the AER's approach that group company media releases, that may list both network and affiliate names, are not considered to be advertisements or promotions under the Guideline.

Registers

Energy Networks Australia suggests that registers published on network websites be updated, where necessary, on a monthly or even quarterly basis to alleviate some of the regulatory burden for networks. Now that networks have their information registers up and running, this approach appropriately balances the timeliness of data updates against the reality that most stakeholders are not reviewing the registers on a regular basis.

Interaction with regulatory sandboxes

Energy Networks Australia believes the Explanatory Statement should be updated to make the interaction between the Guideline and the yet to be developed AER 'Sandbox Guideline' clear.

As the AER's regulatory sandboxes are a new concept since the Guideline was first developed, an overview in the Explanatory Statement as to how the two Guidelines are intended to work together would be both helpful and appreciated.

Appendix A – Further details around functional separation

Proposed change to the definition of 'electricity information'

Proposed definitions - changes from the current definition in blue text	Would comprise information related to:
sensitive electricity information means information about electricity networks, electricity customers or electricity services, other than: (a) aggregated financial information; or (b) other service performance information; or **(c) non-sensitive electricity information** that does not relate to an identifiable customer or **class of customer**.	Customer specific information such as: » usage information » connection information » expansion plans General customer information » forward looking modelling » trends or forecasts Distribution system information: » network design and evaluation information (that is not related to the physical security, cyber security or electrical and mechanical equipment required to operate maintain and repair the network in the course of providing electrical services; » reliability or operational data » expansion or connection plans » tender details from firms providing electricity services to the business
non sensitive electricity information means information about electricity networks, electricity customers or electricity services that is: (a) technical information: i. relating to the physical security or cyber security of the network; or ii. about the electrical or mechanical equipment of the network that is required to operate, maintain and repair the network in the course of providing electrical services; or (b) created or used to achieve individual job specific outcomes and does not provide information on future plans or expectations of a network; or (c) not publicly available information; or (d) not **sensitive electricity information**.	Information relating to the physical security and cyber security of the network Technical, task-based information that does not comprise any information on network planning or strategy such as » Maintenance and installation plans » Equipment operation instructions » Testing and calibration information » Individual work plans Information related solely to asset composition Publicly available information, materials and diagrams including: » RINs » RIT-Ds » DAPRs

An alternative to the above definition is to just expand the definition of **electricity information** to better clarify what is not sensitive information:

Alternative definition - changes from the current definition in blue text	Would comprise information related to:
electricity information means information about electricity networks, electricity customers or electricity services, other than: (d) aggregated financial information; or (e) other service performance information; or that does not relate to an identifiable customer or **class of customer** or (f) technical information: iii. relating to the physical security or cyber security of the network; or iv. about the electrical or mechanical equipment of the network that is required to operate, maintain and repair the network in the course of providing electrical services; or (g) information created or used to achieve individual job specific outcomes and does not provide information on future plans or expectations of a network; or **(h)** publicly available information	Customer specific information such as: » usage information » connection information » expansion plans General customer information » forward looking modelling » trends or forecasts Distribution system information: » network design and evaluation information that is not related to the physical security, cyber security or electrical and mechanical equipment required to operate maintain and repair the network in the course of providing electrical services; » reliability or operational data » expansion or connection plans
	Would NOT comprise information related to:
	Information relating to the physical security and cyber security of the network Information related solely to asset composition such as asset GIS location data, nameplate data, cables and monitoring equipment. Technical, task-based information that does not comprise any information on network planning or strategy such as » Maintenance and installation plans » Equipment operation instructions » Testing and calibration information » Individual work plans Publicly available information, materials and diagrams including: » RINs » RIT-Ds » DAPRs

Proposed definition of ‘class of customer’

Proposed definition
class of customer means a group of customers that share one or more attributes that could be used by the competitive market to provide a commercial benefit. It does not include generic customer groups whose data would provide no potential commercial advantage.

Staff sharing

A suggested approach, from Energex, to classifying staff positions with access to **sensitive electricity information** and whether those positions also have an opportunity to discriminate in favour of the affiliate is shown below. This assessment would inform the development of the staff sharing register.

Classification	High level description of role	Examples of roles	Access to **sensitive electricity information**?	Opportunity to discriminate?
General skilled worker/ Trade skilled worker	Maintaining and constructing network infrastructure and components. Maintain, test, calibrate and manage tools and equipment to approved standards	Power worker Fitter Sheet metal worker Warehouse operator	No	No
Electrical technician/ Technical officer	Construction, repair and maintenance of power supply and telecommunications components. Primarily work in the field traveling to different locations to construct, troubleshoot, diagnose, and resolve problems. Maintain, Test and Calibrate Equipment to approved Standards	Connection officer Cable jointer Linesperson Technical service person	No	No
Engineer/ Other technical professional	Evaluates, estimates, designs, develops and maintains electrical control systems and components to specifications	Engineer Surveyor Distribution property officer Customer projects officers	Yes	Yes
Electrical designers/ design officers	Support engineers with design requirements and drawings which document the type and arrangement of circuits, transformers, circuit breakers, power lines and other equipment	Designer Planner	Yes	No

Following this initial categorisation, a further assessment can be undertaken to determine which roles can be shared or co-located.

For example:

Position type	Access to sensitive electricity information?	Opportunity to discriminate?	Suitable for staff sharing?	Suitable for office sharing?
Linesperson	No	No	Yes	Yes
Power worker	No	No	Yes	Yes
Engineer	Yes	Yes	No	No
Designer	Yes	No	Yes	Yes