



# RING-FENCING WAIVER APPLICATION

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September 2017

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## 1.0 Introduction

The Australian Energy Regulator (AER) Ring-Fencing Guideline Electricity Distribution November 2016 (Guideline) is the first consistent cross-jurisdictional ring-fencing guideline. The Guideline has replaced ring-fencing arrangements under the Independent Pricing and Regulatory Tribunal.

The purpose of the Guideline is to prevent regulated network businesses leveraging their monopoly business in a manner that distorts competition in other markets. The Guideline consists of several components:

- preventing network business from using regulated revenues to subsidise activities in unregulated markets
- ensuring network businesses treat their related businesses and third parties equally
- providing relevant information to all commercial parties on equal basis to support competitive market outcomes
- restricting access of other participants in contestable markets to the services provided by the network business, or providing access on less favourable terms to their related businesses.

The AER requires distributors to comply with the obligations contained within the Guideline as soon as reasonably practicable, with full compliance required no later than 1 January 2018.

Endeavour Energy is committed to implementing the AER's ring-fencing guideline in a way that enhances competition, provides certainty for market participants and ensures robust compliance. Endeavour Energy expects to be fully compliant with the AER ring-fencing guideline within the allowed transition period (i.e. by 1 January 2018)

In recognition of potential unintended consequences and the costs from immediately adopting all ring fencing obligations, the Guideline allows distributors to apply for waivers from the following ring fencing obligations:

- legal separation
- offices, staff, branding and promotions
- conduct of service providers.

### 1.1 Purpose

This application outlines Endeavour Energy's waiver request. In summary, Endeavour Energy is seeking a transitional waiver in respect to new services that will commence during the current regulatory control period and are not currently classified.

### 1.2 Waiver approach

Endeavour Energy has developed its approach to compliance and implementation plan with a focus on achieving the objective of the Guideline by separating Endeavour Energy's monopoly and contestable electricity services. Endeavour Energy's starting point was a top-down approach, to understand which of Endeavour Energy's services would need to be separated from Endeavour Energy's direct control services.

Endeavour Energy undertook a gap analysis for each of its services to determine the scope of compliance activity required for each ring fencing obligation. The outcomes of this gap analysis informed the development of the compliance approach. The gap analysis identified the core focus of the compliance approach would be to separate unregulated distribution services and other services from Endeavour Energy's direct control services.

Endeavour Energy then applied a bottom up approach to develop the compliance approach, addressing each obligation individually across all impacted services. The compliance approach identifies the activities Endeavour will undertake to implement the required changes to become compliant with the Guideline.

Endeavour Energy's objective is to achieve full compliance by 1 January 2018. However, it has identified the need for an immaterial waiver to address transitional issues arising from the introduction of new services during the current regulatory control period which are not currently classified. This waiver seeks to ensure that the intent of the ring fencing framework is preserved, whilst minimising the costs potentially borne by consumers arising from Guideline application.

Endeavour Energy has also identified that there remains a risk that legal separation will not be completed by 1 January 2018. The risk arises from the possibility that approvals we are obliged to obtain from Commonwealth authorities may be delayed due to the nature of their approval processes which is outside our control. This short term waiver seeks to ensure that Endeavour Energy does not breach the ring fencing guideline in the event that the necessary approvals are delayed due to matters outside of our control.

## 2.0 Services subject to reclassification

### 2.1 Waiver details

Endeavour Energy is seeking a waiver from the Guideline's legal separation, office, staff, branding and promotions obligations for a small number of new services, until the end of the 2015 – 2019 regulatory control period, when these services will be classified as alternative control services for the 2019 – 2024 regulatory control period.

**Table 1 – Endeavour Energy proposed waiver**

Services	Ring-fencing Obligation	Commencement Date	Expiry Date	Regulatory Control Period
Network safety services Rectification works to maintain network safety Planned interruption – customer requested Provision of training to third parties for network related access Customer initiated asset relocation Termination of cable at zone substation – distributor required performance Premises connection assets – C. customer requested above standard design and distributor required performance Augmentations – D. customer requested above standard design and distributor required performance Meter recovery and disposal – type 5 and 6 (legacy meters) Distributor arranged outage for purposes of replacing meter	3.1 Legal separation  4.2 Offices, staff, branding and promotions	1 January 2018	30 June 2019	2015 – 2019

### 2.2 Service Description

Endeavour Energy will commence (or has commenced) providing a number of new services during the current regulatory control period, which were not classified. The AER's Framework and Approach for NSW distributors for the Regulatory Control Period commencing 1 July 2019 has proposed these services be classified as alternative control services for the 2019 – 2024 regulatory control period.

**Table 2 – Endeavour Energy new services during 2014-2019 regulatory control period**

Services	Description	Proposed classification for 2019 – 2024 regulatory control period
Network safety services	Examples include: <ul style="list-style-type: none"> <li>provision of traffic control services by the distributor where required</li> <li>fitting of tiger tails, high load escort</li> </ul>	Alternative control (potentially contestable)

	<ul style="list-style-type: none"> <li>de-energising wires for safe approach (e.g. for tree pruning)</li> <li>work undertaken to determine the cause of a customer fault where there may be a safety impact on the network or related component</li> <li>Neutral integrity test – where customers request the distributor to investigate the occurrence of mild electric shocks within a customer's premises to determine whether the fault exists within the customer's installation or on the network. A fee would be levied where the fault is within the customer's installation.</li> </ul>	
Rectification works to maintain network safety	Activities include issues identified by the distributor and work involved in managing and resolving pre-summer bush fire inspection customer vegetation defects or aerial mains where the customer has failed to do so	Alternative control (specific monopoly service)
Planned interruption – customer requested	Where the customer requests to move a planned interruption and agrees to fund the additional cost of performing this distribution service outside of normal business hours	Alternative control (specific monopoly service)
Provision of training to third parties for network related access	Training services provided to third parties that result in a set of learning outcomes that are required to obtain a distribution network access authorisation specific to a distributor's network. Such learning outcomes may include those necessary to demonstrate competency in the distributor's electrical safety rules, to hold an access authority on the distributor's network and to carry out switching on the distributor's network. Examples of training might include high voltage training, protection training or working near power lines training.	Alternative control
Customer initiated asset relocations	Relocation of assets that form part of the distribution network in circumstances where the relocation: <ul style="list-style-type: none"> <li>was initiated by a third party (including a customer); and</li> <li>could impact the safety or security of the network.</li> </ul>	Alternative control (specific monopoly service)
Termination of cable at zone substation – distributor required performance	The termination of cable at zone substations and first joint out, where : <ul style="list-style-type: none"> <li>a work health and safety assessment determines that an ASP should not be given the required access to the zone substation; and</li> <li>the connection is fully dedicated to the specific customer connecting.</li> </ul>	Alternative control (specific monopoly service)
Premises connection assets – C. customer requested above standard design and distributor required performance	Includes any additions or upgrades to the connection assets located on the customer's premises which are contestable (Note: excludes all metering services).  C. Part design and construction of connection assets where a customer requests that connection assets are designed and constructed to an increased standard (beyond that required by the distributors' standards and policies), and where those works are designed and constructed by the distributor (as a result of safety, reliability or security reasons).	Alternative control
Augmentations – D. customer requested above standard design and distributor required performance	D. Any shared network enlargement/enhancement undertaken by a distributor where a customer requests that assets are designed and constructed to an increased standard (beyond that required by the distributors' standards and policies).	Alternative control
Meter recovery and disposal – type 5 and 6 (legacy meters)	Activities include: <ul style="list-style-type: none"> <li>at the request of the customer or their agent to remove and dispose of type 5 or 6 current transformer (CT) meters where a permanent disconnection has been requested.</li> <li>disposing of type 5 or 6 whole current (WC) meters which may otherwise be removed and disposed of by the incoming metering provider.</li> </ul>	Alternative control (specific monopoly service)
Distributor arranged outage for purposes of replacing meter	At the request of a retailer or metering coordinator provide notification to affected customers and facilitate the disconnection/reconnection of customer metering installations where a retailer planned interruption cannot be conducted.	Alternative control (specific monopoly service)

## 2.3 Reason for waiver

The classification of services establishes the ring fencing obligations Endeavour Energy must comply with for individual services for the relevant regulatory control period. Endeavour Energy has a number of

new services that will come into existence during the current regulatory control period, including services related to the Power of Choice reforms, which are not currently classified. The AER's Framework and Approach for NSW distributors states that new services that come into existence within a regulatory control period must be provided separate to the regulated network business, unless it applies for, and receives, a waiver under the Guideline.<sup>1</sup>

The AER's Framework and Approach for NSW distributors has proposed to classify these new services as alternative control services for the 2019 – 2024 regulatory control period. Once the service classification takes effect at the commencement of the next regulatory control period, these services will no longer be required to be ring-fenced from the provision of direct control services. In the absence of this waiver these services would be required to be ring-fenced for a period of only 18 months.

Endeavour Energy is seeking a waiver for the remainder of the 2015 – 2019 regulatory control period to avoid the unnecessary implementation costs that would be incurred for a limited period of time.

### 2.3.1 The potential for cross-subsidisation and discrimination

Endeavour Energy is of the view that there is limited to no potential for cross subsidisation and discrimination in the provision of these services. This assessment is based upon the following:

- Endeavour Energy's Cost Allocation Methodology ensures there is no cross-subsidisation between services, and accounts are auditable under the Guideline. All costs are allocated to services according to the following principles:
  - Items which can be directly attributed to a specific service (distribution or otherwise) are attributed accordingly
  - Items that can be directly attributed to network activities, but not to an individual service are allocated using a causal allocator
  - Items that cannot be directly attributed to network activities are allocated using an appropriate and defensible allocation method.
- There are no opportunities for impacted staff providing these services to discriminate, because:
  - The majority of the new services impact or relate to the safety, reliability or security of the network and involve work on, or in relation to, parts of Endeavour Energy's distribution network. Therefore they can only be performed by Endeavour Energy
  - Endeavour Energy is obliged to provide new services related to Power of Choice reforms, e.g. distributor arranged outage for purposes of replacing meter, and meter recovery and disposal – type 5 and 6 (legacy meters), as the distribution network service provider, and no third party performs these services.

### 2.3.2 Benefits to consumers

Endeavour Energy is of the view that the benefits to customers primarily arise from the avoidance of unnecessary administrative costs that would otherwise be required be borne by customers. This assessment is based upon the following:

- Complying with the ring-fencing obligations for these services would require Endeavour Energy to functionally separate these services, implement staff and office separation, and separate branding for these services for the remainder of the 2015 – 2019 regulatory control period. This functional separation, and separate branding would be reversed following the commencement of the 2019 – 2024 regulatory control period with the reclassification of these services.
- Consumers will benefit from the waiver being granted through lower costs, as Endeavour Energy would not unnecessarily incur the costs of complying with ring-fencing obligations for the remainder of the 2015 – 2019 regulatory control period, and the costs of reversing the arrangements for the 2019 – 2024 regulatory control period when the service classifications will change.

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<sup>1</sup> AER, Framework and Approach for NSW distributors, Regulatory Control Period commencing 1 July 2019, p. 9.

### 2.3.3 National Electricity Objective

Endeavour Energy is of the view that accepting this waiver application will advance the National Electricity Objective to a greater degree than not accepting the waiver application on the basis that:

- Current service classifications pre-date the Guideline and a number of current classifications are being amended, in part due to the consequences of the Guideline's introduction.
- It would not be in the long-term interests of consumers to require compliance with ring-fencing obligations for services that are intended to be re-classified in the next regulatory control period, as it would require Endeavour Energy to unnecessarily incur costs both to ring-fence these services for 18 months and then to subsequently unwind the ring-fencing arrangements.

### 2.4 Cost to achieve compliance

To achieve compliance with the ring-fencing obligations in the absence of a waiver, Endeavour Energy would need to change its business processes for delivering these services as noted above. For example:

- the separation of staff managing the services, including potentially splitting roles, from staff conducting regulated activity and new office accommodation
- expanding the roll-out of the new brand to include these services, including changing phone numbers and call centre procedures for customers to request these services.

Endeavour Energy is of the view that the costs associated with changing business processes for delivering these services would most likely be wasted resources, as this separation would no longer be required from the commencement of the next regulatory control period, when the classification of these services changes to standard control and alternative control services.

## 3.0 Legal separation

### 3.1 Waiver details

Endeavour Energy is seeking a waiver from the Guideline's legal separation of other services until 30 June 2018 to provide additional time to secure approvals from Commonwealth authorities for the establishment of a separate legal entity. Endeavour Energy intends to be compliant with the legal separation requirements by the end of the transition period of 31 December 2017, however there remains a residual risk that matters outside of our control may delay the approval processes. This waiver seeks to address this residual risk.

**Table 3 – Endeavour Energy proposed waiver**

Services	Ring-fencing Obligation	Commencement Date	Expiry Date	Regulatory Control Period
Other Services: Unregulated distribution services Unclassified services	3.1 Legal separation	1 January 2018	30 June 2018	2015 – 2019

### 3.2 Service Description

Endeavour Energy currently provides a number of services that have been classified as unregulated distribution services and a number of services that are currently unclassified, such as transformer workshop and field services.

**Table 4 – Endeavour Energy unregulated services during 2014-2019 regulatory control period**

Services	Description	Classification for 2015 – 2019 regulatory control period
Network premise connections	Connection of premises to the distribution network funded by the customer and undertaken by an ASP.	Unregulated distribution services
Network extensions	Extension to the network to reach a customer's premise that is funded by the customer and undertaken by an ASP.	Unregulated distribution services
Types 1-4 metering services	Provision of types 1-4 meters, meter installation, meter servicing and repairs, meter reading and data management services	Unregulated distribution services
Metering types 5-6 installation services	Installation of types 5-6 meters	Unregulated distribution services
Unclassified services	All services not classified by the AER in the framework and approach.	Unclassified

### 3.3 Reason for waiver

Legal separation is a key component of the ring fencing arrangements and supports market confidence in the avoidance of cross subsidisation and discrimination components of the ring fencing arrangements. Endeavour Energy remains committed to achieving compliance by 1 January 2018; however there remains a residual risk that mandatory approvals required from Commonwealth agencies to enable Endeavour Energy to establish legal separation may not be obtained in time.

The timing has been constrained for Endeavour Energy in this regard due to the long term lease being completed in June 2017. Endeavour has initiated the requisite approval processes however the timelines for a final decision is not certain.

#### 3.3.1 The potential for cross-subsidisation and discrimination

Endeavour Energy is of the view that there is limited to no potential for cross subsidisation and discrimination in the provision of these services. This assessment is based upon the following:

- Endeavour Energy's Cost Allocation Methodology ensures there is no cross-subsidisation between services, and accounts are auditable under the Guideline. All costs are allocated to services according to the following principles:
  - Items which can be directly attributed to a specific service (distribution or otherwise) are attributed accordingly
  - Items that can be directly attributed to network activities, but not to an individual service are allocated using a causal allocator
  - Items that cannot be directly attributed to network activities are allocated using an appropriate and defensible allocation method.
- There will be no weakening in our defences for addressing the ring fencing requirements relating to discrimination, because:
  - Endeavour Energy will be implementing the necessary staff and information separation structures in accordance with the AER guideline by 1 January 2018; and
  - Endeavour Energy will utilise a separate brand, including branding of PPE, that has been developed for our unregulated activities by 1 January 2018.

#### 3.3.2 Benefits to consumers

Endeavour Energy is of the view that the benefits to customers primarily arise from the continuation of unregulated services that would otherwise be ceased and the avoidance of unnecessary administrative costs that would otherwise be required be borne by customers. This assessment is based upon the following:

- In the event that staff employed to undertake unregulated services are required to cease activity due to a delay in administrative decisions, the costs of those staff would be considered a regulatory compliance cost that would borne by the regulated distribution network and therefore passed on to end customers.
- Endeavour Energy is continuing to work towards implementation by 1 January 2018, and therefore approval of this waiver will avoid the need for a late application and request for

expeditious review in the event that approval is not achieved within the timelines required for implementation.

### **3.3.3 National Electricity Objective**

Endeavour Energy is of the view that accepting this waiver application will advance the National Electricity Objective to a greater degree than not accepting the waiver application on the basis that:

- It minimises the potential for resources becoming unproductive, or temporarily stranded until approval is received, with the costs of those resources becoming a regulatory compliance cost.
- It provides clear and timely process certainty for all parties regarding any unregulated activities currently undertaken by Endeavour Energy in the event that approvals are not achieved within the times required for compliance by 1 January 2018.

### **3.4 Cost to achieve compliance**

To achieve compliance with the ring-fencing obligations in the absence of a waiver, Endeavour Energy would need to cease its unregulated activities for the period until approvals are provided by Commonwealth authorities. This would result in costs being recognised within the regulated distribution network business as costs of compliance with a regulatory obligation imposed by the ring fencing guideline that would necessarily be borne by end use customers. At this time it is unclear what if any costs would ultimately arise due to the absence of defined timings for the requisite approval processes.