

28 July 2017

Ms Michelle Groves
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Via email: michelle.groves@aer.gov.au

Dear Michelle

AER RING-FENCING GUIDELINE – RING-FENCING WAIVER APPLICATION

Endeavour Energy has prepared its approach to compliance and developed an implementation plan that focuses on achieving the objective of the AER's Ring-Fencing Guideline (the Guideline) by separating Endeavour Energy's monopoly and contestable electricity services.

Endeavour Energy's objective is to achieve full compliance by 1 January 2018. However, it has identified an immaterial waiver to address transitional regulatory issues arising from service reclassification for the next regulatory control period. The proposed waiver seeks to ensure that the intent of the ring-fencing framework is preserved while minimising the costs potentially borne by consumers arising from our compliance with the Guideline.

In substance the attached ring-fencing waiver application seeks to protect customers from bearing the costs of implementing ring-fencing arrangements where those arrangements will simply be reversed in 18 months when the services are reclassified as regulated services.

Update on Ring-fencing Implementation Program

We have also commenced implementing the Guideline. Consultation with stakeholders is underway, and our corporate website will be updated in the coming days with information that provides an overview of the ring-fencing obligations and Endeavour Energy's compliance approach.

Endeavour Energy has appreciated the engagement received from the AER at all levels throughout the development and socialisation of the Guideline. We would like to meet with you to provide an update on implementing our Ring-fencing Compliance Approach ahead of formally submitting the compliance strategy in early August 2017.

If you wish to discuss Endeavour Energy's proposed ring-fencing approach in further detail, please contact Mr Jon Hocking on (02) 9853 4386.

Yours sincerely



Rod Howard
Chief Operating Officer

Attachments:

1. Ring-fencing Waiver Application



RING-FENCING WAIVER APPLICATION

July 2017

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 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 Guideline within the allowed transition period (i.e. by 1 January 2018).

In recognition of potential unintended consequences and the costs of 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 requests. In summary, Endeavour Energy is seeking a transitional waiver in respect to certain services subject to reclassification in the next regulatory control period.

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 Energy 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 reclassification of services that will apply for the next regulatory control period. 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.

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 services, until the end of the 2015 - 2019 regulatory control period, when these services will be reclassified as either standard control services or 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
Emergency recoverable works	3.1 Legal separation	1 January 2018	30 June 2019	2015 - 2019
Security lights (night watch)	4.2 Offices, staff, branding and promotions			

2.2 Service Description

The AER's Framework and Approach for NSW distributors for the Regulatory Control Period commencing 1 July 2019 has proposed a number of changes to the service classifications and service descriptions for the 2019 - 2024 regulatory control period:

- Emergency recoverable works – work to repair damage to the distribution network caused by a third party (changing from unclassified to standard control services).
- Security lights (night watch) – Customer requested flood lighting services (private security and flood lighting services) (changing from unclassified to alternative control (potentially contestable)).

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. The AER's Framework and Approach for NSW distributors proposes changes to service classifications for the next regulatory control period. In particular, some services that are currently unregulated or unclassified are proposed to be classified as alternative control services or standard control services. Once the service reclassification occurs 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:
 - Emergency Recoverable Works are works undertaken in connection with the distribution system, and the only entity that provides these services is Endeavour Energy. These works are currently only classified differently to other repairs to the network as the cost of the works may be recovered from the parties responsible for causing the damage rather than all network users. As this service is not competitive, discrimination is not possible.
 - Security lights (night watch) is considered to be a potentially contestable service and the AER has proposed to classify it as an alternative control service for the next regulatory control period. The market for Security lights (night watch) lighting in Endeavour Energy's network is small, with few active competitors. Endeavour Energy is the only provider of security lights (night watch) on Endeavour Energy assets (e.g. distribution poles) and does not actively promote the provision of security lights (night watch). The AER's proposed classification of alternative control services for 2019 - 2024 regulatory control period recognises there is potential for competition in this market, however at present there is little to no competition in the market. As such, Endeavour Energy is of the view there is no opportunity for staff to discriminate.

2.3.2 Benefits to consumers

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

- Complying with the ring-fencing obligations for these services would require Endeavour Energy to functionally separate security lights (night watch) and emergency recoverable works, 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.

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:

- Emergency recoverable works – Endeavour Energy would need to establish a new brand and branding material, including uniforms and fleet branding for this service.
- Security lights (night watch) – Endeavour Energy would need to establish a new brand, branding material (uniforms, fleet branding and marketing material) and potentially would need to split roles and relocate staff in the lighting team.

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.

