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28 September 2016

Mr Chris Pattas
General Manager, Networks
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001
Email: Ringfencingguideline2016@aer.gov.au

Dear Mr Pattas

Submission on the Draft Electricity Ring-Fencing Guideline

Ergon Energy Corporation Limited (Ergon Energy) welcomes the opportunity to provide comment to the Australian Energy Regulator (AER) on its *Draft Electricity Ring-Fencing Guideline*. This attached submission is provided by Ergon Energy, in its capacity as a Distribution Network Service Provider (DNSP) in Queensland.

Should you require additional information or wish to discuss any aspect of this submission, please do not hesitate to contact either myself on (07) 3851 6416, or Trudy Fraser on (07) 3851 6787.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jenny Doyle', written over a horizontal line.

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Group Manager Regulatory Affairs

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Submission on the *Draft Ring-Fencing Guideline – Electricity Distribution*

28 September 2016



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Australian Energy Regulator

28 September 2016

This submission, which is available for publication, is made by:

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Introduction

Ergon Energy Corporation Limited (Ergon Energy), in its capacity as a Distribution Network Service Provider (DNSP) in Queensland, welcomes the opportunity to provide comment to the Australian Energy Regulator (AER) on its *Draft Ring-Fencing Guideline* (the Draft Guideline) and accompanying Explanatory Statement.

As a member of the Energy Networks Association (ENA), the peak national body for Australia's energy networks, Ergon Energy has also contributed to and is fully supportive of the issues raised in the ENA's submission.

Ergon Energy supports the need for a national ring-fencing guideline in the context of rapidly changing technologies and the emergence of new products and services, and we appreciate the AER's efforts in developing the Draft Guideline. We consider it of utmost importance that the Ring-Fencing Guideline promotes the achievement of the National Electricity Objective (NEO) by serving the long term interests of electricity consumers. Fundamentally, ring-fencing requirements should exist only to the extent that they enhance the NEO and are within the realm of best practice regulation. They should not create regulatory uncertainty.

Furthermore, ring-fencing requirements should strike the right balance between the establishment and maintenance of a level playing field in the provision of energy services in both existing and emerging markets, and the ability for DNSPs to operate effectively within those markets, consistent with the NEO. In this regard, Ergon Energy is concerned that certain aspects of the Draft Guideline will operate to force DNSPs out of new and emerging markets and will restrict their future participation in initiatives that have been developed in pursuit of a more sustainable and efficient market. This is of particular concern to Ergon Energy as we continue to focus on minimising cost increases for our regional Queensland customers.

Ergon Energy agrees with the objectives of addressing two specific harms being cross-subsidisation and discrimination. We also note the AER has indicated they have had regard to the Council of Australian Governments' (COAG) best practice regulation principles when developing the Draft Guideline. Ergon Energy agrees that the COAG principles provide a constructive framework. However, we believe these principles could be met in better ways than is currently the case in the Draft Guideline. Ring-fencing arrangements should be proportional and targeted, and only apply where competition concerns are material. The obligations in the Draft Guideline far exceed what is required to meet the AER's objectives. Under the current drafting, DNSPs may incur excessive (and potentially unnecessary) compliance costs with no customer benefit to be realised.

Ergon Energy supports the approach of ring-fencing services rather than assets. We also acknowledge the material changes the AER has made from their Preliminary Positions paper to address stakeholder concerns. These changes go some way to distinguish between unfair advantage and utilising the advantages of economies of scale and scope. For example, the ability to share corporate staff allows DNSPs to provide distribution services more efficiently, which is in the long term interests of consumers.

Despite this, Ergon Energy has a number of concerns with the Draft Guideline and we have detailed our feedback on the Draft Guideline below under a series of key themes and provided some drafting suggestions in Appendix A. Ergon Energy acknowledges the task of developing a nationally consistent ring-fencing guideline is challenging. However, it is critical that the Final Ring-Fencing Guideline (the Final Guideline) is effective from 1 December 2017. Given the criticality of having effective guidelines in place, Ergon Energy requests that the AER release an early

exposure draft prior to publication of the Final Guideline. Ergon Energy is available to discuss this feedback or provide further detail regarding the issues raised, should the AER require.

Key issues

Ergon Energy has grouped our feedback on the Draft Guideline and accompanying Explanatory Statement under a number of 'key themes', as described below. Within each of these we have outlined any issues we have identified with the Draft Guideline and accompanying Explanatory Statement, and where appropriate have included details of our preferred position. Ergon Energy strongly recommends these issues are further considered by the AER prior to the release of the Final Guideline.

Terminology and definitions

Ergon Energy is concerned that the Draft Guideline has created ambiguity in its scope and uncertainty regarding its practical application as a result of the inconsistent and interchangeable use of terminology throughout the Draft Guideline and Explanatory Statement. This concern is further compounded by the fact that the AER has introduced a number of new terms without definition. Together, these would create both regulatory uncertainty and risk for DNSPs, in seeking to comply with their ring-fencing obligations. The particular areas of concern identified by Ergon Energy are as follows:

- The Draft Guideline requires the legal separation of network services that can only be provided by a DNSP from non-network services. We understand that the terminology of network services was used with a view to permitting distribution and transmission services to be performed by one legal entity. However, the Draft Guideline is ambiguous. This is because the meaning of network service appears narrower than the meaning of distribution service under the National Electricity Rules (NER).

Network services are defined in the NER as:

Transmission service or distribution service associated with the conveyance, and controlling the conveyance, of electricity through the network.

while distribution service is defined in the NER as:

A service provided by means of, or in connection with, a distribution system.

and distribution system is defined in the NER as:

A distribution network, together with the connection assets associated with the distribution network, which is connected to another transmission or distribution system.

Connection assets on their own do not constitute a distribution system.

However, the definition of network is:

The apparatus, equipment, plant and buildings used to convey, and control the conveyance of, electricity to customers (whether wholesale or retail), excluding any connection assets. In relation to a Network Service Provider, a network owned, operated or controlled by that Network Service Provider.

If the more narrow meaning of network services is to apply (i.e. a subset of Standard Control Services), DNSPs such as Ergon Energy would be precluded from providing certain services, such as connection services which are classified as Standard Control Services or 'services provided in relation to a Retailer of Last Resort event', some 'other recoverable works' and 'public lighting', which have been classified as Alternative Control Services (i.e. distribution services) in Ergon Energy's Final Distribution Determination (FDD).

Consequently Ergon Energy strongly supports the use of the term 'distribution service' in preference to 'network service' as we consider the term 'distribution service' more accurately reflects the intent of the Draft Guideline and will not impede the continued delivery of these functions in the most efficient and cost effective manner. In the absence of this desired consistency it will be difficult for DNSPs such as Ergon Energy to understand exactly what the AER intends. This will lead to potential inconsistent interpretation and application of the Guideline by different DNSPs and will heighten the risk of non-compliance for those parties.

As a consequential amendment, references to "non-network" services should be replaced with "services other than distribution services and transmission services".

- The Draft Guideline has introduced the term, "energy-related services". This has been highlighted in bold to indicate it has the meaning given in the NER. However, no such term exists in the NER. Based on our understanding of what the AER is seeking to achieve by distinguishing "energy-related services" from other services provided by DNSPs, Ergon Energy recommends the following definition of "energy-related services" provides the desired clarity for DNSPs and is in keeping with the intent of ring-fencing:

Energy-related services means electricity services other than distribution services or transmission services, that are provided to end users on a contestable or competitive basis.

- The definition of body corporate in the Draft Guideline appears to capture the State of Queensland. Consequently, Ergon Energy would be restricted in its interactions with the State of Queensland as a related body corporate. This appears to Ergon Energy as an unintended consequence of the drafting which would, among other things, prevent information flows between Ergon Energy and the State of Queensland, despite such information flows being legally required under other instruments. To avoid this likely unintended consequence, Ergon Energy recommends the use of the body corporate definition in the Annual Reporting Regulatory Information Notice.
- While the Explanatory Statement indicates it is the AER's intention that the provisions relating to providing the same quality, reliability and timeliness of service; and to advertising, promoting and branding, should apply to "competitive and contestable energy-related markets"¹, this is not reflected in the Draft Guideline. Ergon Energy suggests that the Guideline make it clear that this provision only applies to related bodies corporate providing a competitive or contestable energy-related service.
- Clause 4.1(a) of the Draft Guideline provides that a DNSP must not discriminate between a related body corporate and a competitor of that related body corporate "in connection with the

¹ AER (2016), *Draft Ring-fencing Guideline, Explanatory Statement*, August 2016, p35.

supply of distribution services or non-distribution services”. Although it is implicit through the use of the terms “distribution services” and “non-distribution services” that this should mean the services provided by a DNSP, Ergon Energy recommends that clause 4.1(a) be reworded to make it clear that the obligations listed therein apply only in relation to the DNSP’s provision of distribution services.

Classification of services

Ergon Energy notes that the Draft Guideline is centred on the ring-fencing of services, with the effect that DNSPs must only provide distribution services, except to the extent that the costs of providing other services falls below the materiality threshold prescribed in the Draft Guideline. Consequently, it appears to Ergon Energy that under the proposed ring-fencing arrangements, with the exception of any non-distribution services provided under the materiality threshold, a DNSP will only be permitted to provide those services classified as distribution services under a FDD applying to it. Noting that each of the impacted jurisdictions is at different stages of their regulatory determination process, with differing applications of the classification of services, this will make it extremely difficult to apply a nationally consistent ring-fencing regime from commencement in the absence of suitable transitional arrangements.

Furthermore, Ergon Energy’s most recent classification of services, under our FDD, took effect on 1 July 2015. During the preceding consultation period, neither Ergon Energy, the AER nor other stakeholders were aware of the likely impact of ring-fencing on Ergon Energy’s service classification. This is evidenced by the fact that there are a number of services which have not been classified by the AER under our FDD, which if considered in the context of the proposed ring-fencing arrangements, would likely have been more properly considered as unregulated distribution services (i.e. *services provided by means of, or in connection with, a distribution system*).

To address this issue, Ergon Energy considers that a number of services currently treated as non-distribution services in our FDD should, for the purposes of this Guideline, be considered “distribution services” until the next distribution determination takes effect (at which time, services will be appropriately classified through the Framework and Approach process²). These services include:

- Rental and hire services – Rental of distributor owned property
- Test, inspect and calibrate – Calibration and testing of equipment for external party products
- Property services
- Contracting services to other network service providers – Services such as emergency response and highly specialist cable jointers, provided to other network service providers
- Provision of training to external parties
- Equipment service
- Sale of inventory, asset or scrap
- Operate and maintain customer assets.

² The classification of distribution services must be as set out in the relevant Framework and Approach paper, unless the AER considers that unforeseen circumstances justify a departure (clause 6.12.3(b) of the NER).

All of these services arguably meet the broad definition of distribution services in that they are provided by means of, or in connection with, a distribution system. In many instances there are wider benefits to DNSPs providing these services. For example:

- The provision of training to external parties provides confidence that electrical contractors' work is of a high standard which ultimately promotes the effective operation of the distribution network (and assets that connect to the distribution network) and promotes public safety.
- For services such as the erection of customer owned poles, Ergon Energy currently offers this service to customers during the connection process to facilitate fast and efficient access to supply at the connection point. If we were prevented from doing this under ring-fencing arrangements, customers would likely experience delays and additional costs in having supply connected to their premises, particularly in Ergon Energy's distribution area where travel distances to customer premises can be significant. For example, if we travelled to a rural or remote area to perform a new connection but a customer property pole was required, we would need to return to the depot leaving the premises not connected. The customer would then need to arrange a separate visit from a third party to install a property pole before Ergon Energy could return to energise the premises. This would add significant cost and time to the customer connection. This is clearly not in the best interests of customers and is inconsistent with the NEO.

Ergon Energy does not consider services, such as rental and hire services, that are subject to the Shared Asset Guideline (SAG) should be captured by these legal separation provisions as these services are incidental to and provided by virtue of being a DNSP. Ergon Energy notes that under the SAG and the shared asset principles in the NER which underpin them, DNSPs should be encouraged to use assets that provide Standard Control Services for the provision of other kinds of services where this is efficient and does not materially prejudice the provision of those services.

In Ergon Energy's view, the impact of this proposal on the markets for the provision of these services would be negligible or non-existent. Any concerns regarding cross-subsidisation are more than adequately addressed through the existing Cost Allocation Method. This pragmatic approach avoids unnecessary additional administrative costs associated with legal and functional separation for no customer benefit.

To address our concerns described above, Ergon Energy recommends that the Final Guideline include the drafting in relation to distribution services included in Appendix A. However, notwithstanding Ergon Energy's preference for these amendments to the drafting, if the AER is not supportive of this approach, then as a minimum we strongly urge the AER to consider the issue of a 'bridging waiver' in such circumstances that would apply until the end of an impacted DNSP's current regulatory control period. This will ensure that both DNSPs and the AER are given the opportunity as part of a subsequent regulatory determination process, to properly propose and consider an appropriate service classification, bearing in mind ring-fencing requirements.

Additionally, Ergon Energy is concerned by the proposed treatment of new services that are created mid-period. The Explanatory Statement infers that if a new service is created and does not fit into an existing service grouping classification, it is by virtue of that fact not classified and as such should be treated as a non-network service. Ergon Energy's preference is that if a service created mid-period meets the definition of a distribution service under the NER, it should be treated as a distribution service for the purposes of ring-fencing, regardless of whether it fits into an existing service grouping or not. This is in keeping with the fundamental intention of ring-fencing (i.e. the separation of distribution services by DNSPs from other services provided by them or their related bodies corporate). However, it will also avoid any unnecessary costs associated with the

separation of such services, which would subsequently be classified as a distribution service as part of the next Framework and Approach process.

Materiality threshold

In accordance with clause 3.1(a) of the Draft Guideline, a DNSP may incur costs of up to \$500,000 in any regulatory year for providing non-network services. Following recent engagement with the AER, Ergon Energy understands the AER may intend this as a mechanism to allow DNSPs to trial 'start-up non-network initiatives' rather than as a mechanism to allow DNSPs to provide limited non-network services on an ongoing basis. However, this appears inconsistent with the Explanatory Statement which states that the AER "consider a materiality threshold is required to enable a DNSP to provide limited non-network services that are incidental to, but necessary to support the provision of, its network services".³ Given this ambiguity, Ergon Energy is concerned that if the intent is in fact for this threshold to apply to incidental costs associated with the provision of network services, both the structure and quantum of the threshold is insufficient to give effect to this outcome.

While Ergon Energy notes the AER's preference for a fixed dollar threshold on the basis that it would achieve a more balanced outcome, we do not agree, particularly in view of the insignificant amount proposed in the Draft Guideline. The relative insignificance of this amount is compounded by our concerns cited above in relation to our current classification of services which will, in the absence of suitable bridging or transitional arrangements, prevent Ergon Energy from continuing to provide those services notwithstanding the fact that we consider they reasonably constitute distribution services. Although the proposed materiality threshold would provide some scope for the continued provision of such services under the current classification, this would be substantially limited by the low value of this threshold.

While it remains our strong preference for the classification of services anomalies to be dealt with as described in the preceding section, where the AER is not open to such an approach we request that consideration be given to expansion of the materiality threshold provision in the Draft Guideline to encompass a series of thresholds distinguished by service grouping. Under this approach, services could be grouped according to market influences and an appropriate materiality threshold (proportionate to the harm to be avoided) applied to each, rather than a single threshold aggregated across all services.

Conversely, if the intent is for the threshold to apply as a mechanism to support DNSPs trialling 'start-up non-network initiatives', Ergon Energy suggests the AER should consider basing the threshold on a 'duration' rather than a dollar amount. This would ensure that DNSPs could trial and/or provide certain services for the benefit of their customers without infringing ring-fencing obligations. Furthermore, where a materiality threshold would permit a DNSP trialling a non-network initiative it needs to be clear that the obligations relating to legal separation etc. would not apply during the trial period.

Finally, in relation to the materiality threshold, Ergon Energy notes the reference in the Explanatory Statement to 'incurred' costs⁴, which implies actual cost rather than forecast costs. This creates uncertainty. From a compliance perspective, the materiality threshold should be based on forecast costs. If costs are higher than forecast, a business may not know that it has breached this obligation of the Ring-Fencing Guideline until it is too late to implement compliant arrangements.

³ Ibid p24.

⁴ Ibid.

Shared Asset Guidelines

As previously noted in our comments regarding the classification of services, Ergon Energy is concerned that there is an apparent, though likely unintended conflict between certain provisions in the Draft Guideline and the SAG and shared assets principles which underpin the operation of that Guideline. Specifically, noting the statement in clause 2 of the Draft Guideline that it is to be read in conjunction with, among other things, the shared asset provisions in clause 6.4.4 of the NER and the SAG, it appears quite clear that the AER intends for these frameworks to operate on a complementary rather than competitive basis.

Based on Ergon Energy's understanding of the operation of the shared asset mechanisms in the current regulatory framework, it appears that we can continue to use regulated assets for other purposes, subject to compliance with the regulatory requirements applicable to asset sharing. An example of regulated assets for which Ergon Energy currently earns unregulated revenue includes power poles used to support high speed fibre cables.

Ergon Energy considers that the operation of the SAG ensures that there is no risk of DNSPs over-recovering their asset costs. That is, the SAG operates to ensure that DNSPs cannot recover asset costs from both consumers of regulated electricity supply services and consumers of unregulated services. This ensures that the price of providing those services properly reflects the cost of the assets used to provide the services. Ergon Energy considers this is consistent with the objective of the Ring-Fencing Guideline in preventing DNSPs inefficiently inflating their prices for direct control services and regulated transmission services. Furthermore, previous statements by the AER that they "consider our proposed [shared asset] method leads to reasonable cost reductions and thus meets the NER requirements and appropriately shares benefits with consumers"⁵ appear to emphasise this point. On this basis, Ergon Energy is of the strong view that any costs relating to shared assets managed in accordance with the SAG should not contribute to the materiality threshold for non-network services prescribed in clause 3.1(b) of the Draft Guideline.

Additionally, new technology may present future opportunities to use regulated assets for purposes not originally envisaged when the assets were first established. A complementary application of the respective frameworks, as described above, would provide better certainty for service providers in terms of business planning and investment, with flow-on benefits for consumers. It would also help to ensure the ongoing efficiency of the electricity supply chain and reduce the potential for inefficient duplication of assets or functions and/or the effect of regulatory compliance costs.

Disclosure of information

Ergon Energy generally supports the intent of information access and disclosure obligations. However, we note that Chapter 8 of the NER contains information access and disclosure obligations for all Registered Participants – which includes Ergon Energy as a Network Service Provider (NSP).

The Ring-Fencing Guideline as currently drafted duplicates this regulation and, in places, imposes more onerous obligations on NSPs without clear justification for doing so. Ergon Energy considers that a consistent framework should apply equally to all Registered Participants and that the NER provisions best achieve this.

⁵ AER (2013), *Explanatory Statement, Shared Asset Guideline*, November 2013, p22.

Duplication

Ergon Energy considers that clause 4.3.1 of the Draft Guideline should be removed as we must keep confidential any confidential information provided by a customer, prospective customer or service provider for direct control services under the NER.

Specifically, clause 8.6.1(a) of the NER states:

Each Registered Participant must use all reasonable endeavours to keep confidential any confidential information that comes into the possession or control of the Registered Participant or of which the Registered Participant becomes aware.

Further, clause 8.6.1(b) states that a Registered Participant:

- (1) must not disclose confidential information to any person except as permitted by the NER*
- (2) must only use or reproduce confidential information for the purpose for which it was disclosed or another purpose contemplated by the NER.*

Both of these clauses have civil penalty provisions attached to them – providing sufficient incentive for DNSPs to not disclose confidential information inappropriately.

Disclosure

As currently drafted, clause 4.3.3 of the Draft Guideline prevents DNSPs from disclosing information acquired in providing direct control services to any party without obtaining the explicit informed consent of the relevant customers or prospective customers to whom the information relates. This would include the release of information to parties such as the AER, jurisdictional regulators and contractors undertaking work on our behalf. This is not feasible in practice and does not align with current provisions in the NER.

In particular, clause 8.6.2 of the NER provides exceptions in relation to the disclosure of confidential information. This includes, for example, the disclosure of information to:

- the AER, Australian Energy Market Commission or any other regulatory authority having jurisdiction over a Registered Participant, pursuant to the NER or otherwise;
- employees or officers of the Registered Participant or a related body corporate, and consultants of the Registered Participant, which require the information for the purposes of the NER, or for the purpose of advising the Registered Participant or the Registered Participant's Disclosee; and
- other service providers, with respect to National Metering Identifier (NMI) Standing Data (e.g. premises address, NMI checksum, network tariff, NMI classification code and date of next scheduled meter read).

Obtaining the explicit informed consent of the customer or prospective customer would also be costly in practice, especially for existing customers with no benefit given existing confidentiality obligations.

For these reasons, Ergon Energy believes clause 4.3.3 of the Draft Guideline should be removed.

In the event the AER decides to include a disclosure provision in the Final Ring-Fencing Guideline, it needs to allow for exemptions in line with those detailed in clause 8.6.2 of the NER.

We also believe the exemptions should be expanded to include information we are required to provide under jurisdictional legislative and regulatory instruments. For example, under clauses 120AA and 120AC of the *Electricity Act 1994* (the Act), Ergon Energy may be required to appoint an independent auditor to carry out an audit of:

- our compliance with the Act, Electricity Distribution Network Code and the Distribution Authority; and
- the reliability and quality of information given to the regulator.

This requires Ergon Energy to provide information to the auditor in order for them to carry out the audit. Under the proposed Draft Guideline, we would not be able to provide this information.

Sharing of information

For clarity, we suggest clause 4.3.2 should specify that if the information is provided to a related body corporate in relation to energy-related services, it is made available to third parties competing with the related body corporate in relation to the same or similar energy-related services.

Physical separation

The Draft Guideline requires compliance with the physical separation and staff sharing obligations within six months of commencement. Ergon Energy considers this is unrealistic given the significant costs and time associated with achieving compliance. Currently, Ergon Energy has staff located throughout regional Queensland operating across many business units that perform both distribution and non-distribution services. To unwind staff and seek alternative accommodation or seek a waiver in certain circumstances will require a substantial investment of time, effort and money. This will be exacerbated in the event that Ergon Energy is required to terminate leases early and by the high likelihood of having difficulty in finding alternative accommodation in some of our regional locations. While the Draft Guideline includes provision for waivers to be obtained, it is not sufficient for Ergon Energy to rely on a waiver being granted within the period provided.

There is expected to be a significant impact on property costs that would inevitably be passed through to the customer in order to comply with the proposed ring-fencing requirements. Due to the limited time available to respond, detailed analysis of the cost implications to segregate across the State have not been quantified. However, the following example provides an appreciation of the commercial implications from one circumstance alone. In one regional location, to physically separate staff that provide both distribution and non-distribution services in different physical locations would require leasing of additional accommodation at a cost of approximately \$200,000 per annum, with the existing building being under-utilised. To renovate the existing building to lease out floors would cost in the order of \$3 million.

As the costs of physical separation to comply with the Draft Guideline will be significant, Ergon Energy considers the physical separation requirements to be severe and disproportionate to the harm the AER is seeking to prevent. We consider that the AER can ensure that a DNSP does not confer a competitive advantage to its own related party with less onerous physical separation obligations, such as separate floors with restricted swipe card access. This solution would impose significantly lower compliance costs and achieve a similar if not the same outcome.

Ergon Energy also considers it appropriate that exemptions provided for physical separation obligations under clause 4.2.1(b) should align with the exemptions provided for staff sharing obligations under clause 4.2.2(b).

Finally, Ergon Energy is also concerned by the requirement in the Draft Guideline to prevent service providers from being physically located with a DNSP. This requirement is overly restrictive and unworkable. Ring-fencing obligations sit with DNSPs not service providers. However, DNSPs have no ability to either force service providers to relocate from an existing shared location or prevent them from moving in to the same building in the future. Therefore, the obligation in relation to physical separation should be limited to the DNSP and a related body corporate that provides energy-related services.

Waiver provisions

Ergon Energy believes under limited circumstance waivers should be available for all obligations. For example, in accordance with the Draft Guideline, Ergon Energy would be severely limited in its dealings with Ergon Energy Queensland Pty Ltd (EEQ), as its related body corporate. This is despite the fact that EEQ is a service delivery retailer rather than a commercial retailer because under current legislation it is restricted in legislation from seeking new customers, or offering existing customers a contract other than the Standard Retail Contract at a price other than the gazetted notified prices. On this basis EEQ has no incentive to seek or use information about any customers to obtain a competitive advantage.

It should be noted that consistent with existing ring-fencing obligations, Ergon Energy has established a separate legal entity for EEQ and separate accounts, does not provide preferential network access and appropriately applies the Cost Allocation Method. This ensures there is no cross-subsidisation or discrimination. However, the Draft Guideline imposes additional obligations in relation to non-discrimination and information that would increase costs for no benefit. However, in the Draft Guideline there is no ability to seek a waiver from these obligations.

Similarly, Ergon Energy owns 33 stand-alone power systems connected to our distribution networks in isolated communities. Ergon Energy currently has a ring-fencing waiver to allow us to own and operate these generators to ensure supply to these remote communities in the most efficient and effective manner and the Cost Allocation Method ensures that no cross-subsidisation occurs. Under the Draft Guideline, Ergon Energy would be required to separate the ownership and operation of the isolated networks and generation, losing the efficiencies inherent in the current arrangement and thereby increasing costs for no benefit to customers.

In such limited circumstances, a waiver should be available. Ergon Energy further suggests that such circumstances should also be able to be taken into account when assessing ring-fencing waiver applications as there is no ability to influence the competitiveness of the market. For completeness Ergon Energy notes that should such circumstances change the waiver would be reviewed.

Similarly in other situations where the costs of compliance substantially outweigh the likely benefits to electricity consumers, a waiver should be available for the legal separation, non-discrimination and information access and disclosure provisions.

Ergon Energy also recommends a force majeure exemption clause be inserted into the Final Ring-Fencing Guideline – that is, the obligations in the Guideline do not apply during a force majeure event. This would allow DNSPs to react quickly to natural disasters and/or emergency events without fear of breaching a ring-fencing obligation. Additionally, the imposition of a requirement to seek temporary waivers in such situations would significantly delay a DNSP's response effort, thereby impacting customers and undermining the achievement of the NEO with respect to reliability, safety and security.

As noted above, if Ergon Energy's suggested approach to defining distribution services is not accepted, bridging waivers should be allowed until the next regulatory control period.

Ergon Energy believes that when assessing a waiver application, the assessment needs to be broader than the achievement of the NEO. Consideration should also be given to prevailing market conditions to assess the potential impact on competitive markets of granting a waiver. In some services markets, fully contestable markets are unlikely to eventuate. In these circumstances customers will bear compliance costs for little benefits.

Finally, Ergon Energy notes that the waiver process proposed by the AER requires minor amendments. Specifically, in relation to clause 5.2.3(b), if the AER has conducted a public consultation process there should be a mandatory requirement to publish the reasons for the decision. Further, in relation to clause 5.3(a), the AER should be required to consult with the DNSP in all circumstances where they are reviewing an existing waiver.

Transitional periods

Ergon Energy notes that in the Draft Guideline, the AER has proposed the following transitional periods:

- 12 months after the commencement date⁶, that clause 3.1(a), legal separation, must be complied with; and
- six months after the commenced date⁷, that clauses 4.2.1 and 4.2.2, physical separation/co-location and staff sharing, must be complied with,

with all remaining obligations to take effect from 1 December 2016.

Ergon Energy has serious concerns with this proposal as it will impose significant compliance costs. A longer transitional period would minimise costs. Therefore, we request that the AER give further consideration to extending the timeframe for compliance with most obligations to a minimum of 12 months, subject also to consideration of the issues highlighted below.

While Ergon Energy notes the AER's intention to ensure compliance as soon as possible, we consider this should be appropriately weighted against the cost impacts of minimal implementation periods and the associated impact on service delivery to a DNSP's customers.

Ergon Energy notes that a DNSP's Framework and Approach will play a central role in the application of the ring-fencing guideline going forward and is subject to change each period. The positions set out in the final Framework and Approach do not become final until the AER publishes its final Distribution Determination, usually two months prior to commencement of the regulatory control period. Two months would be insufficient time to develop and implement changes to systems and processes to ensure compliance with any change in the classification of services. Therefore, Ergon Energy recommends the Guideline provide for a 12 month transition in these circumstances.

Legal separation

Ergon Energy requests that the AER have regard to the requirement for any existing contracts to be novated to avoid an infringement of the legal separation obligations, prescribed in the Draft

⁶ 1 December 2017 is 12 months from the commencement date set out in clause 1.1 of the Draft Guideline.

⁷ 1 June 2017 is six months from the commencement date set out in clause 1.1 of the Draft Guideline.

Guideline. This process will be complex and may require negotiations depending on the type of contract, services offered under the contract, the counterparty and the complexity of the contract. There may also be reputational risk and adverse customer impact in unwinding contracts. Due to the inherent complexity and related sensitivity of these issues, Ergon Energy cannot guarantee that they will be resolved by 1 December 2017, particularly given the range of external factors outside of our control.

Physical separation and staff sharing

As noted above, this obligation would impose significant costs on customers and the objective is better achieved through less onerous physical separation obligations, such as separate floors with restricted swipe card access. To the extent the AER does not agree with this approach, it should be noted that significant time will be required to achieve compliance. Similarly there is significant time associated with addressing the staff sharing requirements. While the Draft Guideline includes provision for waivers to be obtained for both obligations, it is not sufficient for Ergon Energy to rely on a waiver being granted within the period provided. In consideration of these issues, Ergon Energy requests that the AER consider extending the timeframe for compliance with these obligations to ensure that the cost of compliance is appropriately balanced against the risk of harm during the transition to compliance.

Remaining obligations

Ergon Energy considers that an expectation by the AER that DNSPs will be able to comply with all remaining obligations by 1 December 2016 is neither reasonable nor practicable. Firstly, Ergon Energy considers the obligations for which transitional arrangements have been provided are so interrelated with the remaining obligations that it is near impossible to segregate those obligations for the purposes of defining an appropriate timeframe for commencement. For example, if in accordance with the legal separation requirements, a new separate legal company is created, new branding will be required.

Additionally, as Ergon Energy's corporate brand is shared by EEQ it will take significant time to unwind the corporate branding for these companies. Ergon Energy envisages that at least the following work will be required:

- a Board decision on brand;
- re-branding all customer communications;
- physical separation of all website content; and
- unwinding of social media, analytics and search capability.

Our concerns in this regard are further compounded by the fact that we are approaching storm season, during which the risk to our customers increases as does the need for our business' responsiveness to minimise the impacts of this season on our customers. Ergon Energy simply cannot comply with this obligation by 1 December 2016 and as such, we strongly suggest the AER allow for a suitable transition period for compliance with this obligation. Based on our analysis of the requirements to achieve compliance, Ergon Energy notes we would need at least 18 months within which to comply with clause (4.1.(b)(vi) and its associated advertising obligation under clause 4.1(b)(v).

In terms of the information access and disclosure obligations in clause 4.3, Ergon Energy will be required to identify impacted areas and what system changes will be required to support these obligations. In addition, Ergon Energy will need to develop and commence training on information

disclosure requirements/limitations and develop supporting protocols. Ergon Energy considers that an appropriate timeframe within which to comply is 12 months. However, we expect that at least 18 months would be required for the implementation of any required system changes. Furthermore, Ergon Energy considers we would need at least three months to comply with the obligation to separate financial accounts and for the discrimination provisions (apart from branding and advertising as noted above).

Finally, notwithstanding the abovementioned concerns, Ergon Energy notes that in accordance with existing ring-fencing requirements, we already comply with clauses 4.1(b)(i)-(iv) in relation to EEQ.

Other Issues

In the Explanatory Statement, under Case 1, the AER states that “...if the DNSP was able to be flexible and allowed the metering service provider (either its affiliate or a third party) to provide the connection services on its behalf, only one truck visit would be required.”⁸ Ergon Energy is concerned that this statement is in conflict with the requirement under the *Electrical Safety Act 2002* (Qld) that the distributor perform the electrical testing of the connection prior to it being energised. Ergon Energy’s records indicate that from 14 March to 24 August 2016, 2.2% of meter service orders failed electrical testing. This means that potentially a large number of installations during that period could have been connected unsafely if an electrical contractor performed both the meter installation and connection without a distributor performing and testing compliance of the electrical installation. This creates an unacceptable risk to consumer safety. While Ergon Energy notes there is an Accredited Provider Scheme in New South Wales that may allow for this to occur, there is no equivalent scheme in Queensland. As such, any proposal to allow contractors to undertake connection services on behalf of a distributor would need a framework to support this arrangement. This would take significant time to develop and implement and is a decision outside the control of a DNSP.

Finally, Ergon Energy is concerned that a non-prescriptive approach may cause too much uncertainty and necessitate a requirement to demonstrate an overly high standard of compliance. Clause 6.2.1(b) of the Draft Guideline requires that DNSPs submit an assessment of compliance by a suitably qualified independent authority. In the absence of any prescription in the Guideline, Ergon Energy is concerned that independent compliance audits will be undertaken using an overly cautious and strict interpretation of the Guideline provisions, which may in fact go beyond what the AER intended. To balance this risk, Ergon Energy suggests that rather than an independent *audit*, the Ring-Fencing Guideline require an independent *review* which would still satisfy the requirement for an independent assessment of compliance.

⁸ p61.

Appendix A: Proposed drafting suggestions

Clause	Issue	Proposed alternative drafting						
Definition of “network services”	Unclear in application	Replace reference to “network services” in Section 3.1 with “distribution services and transmission services”						
Definition of non-network services	Not defined	Replace reference to “non-network services” with “services other than distribution services and transmission services”						
Definition of “distribution services”	Not defined	<p>“distribution services” mean:</p> <ul style="list-style-type: none">a) those services classified as distribution services in the DNSP’s Distribution Determination; andb) until the date the DNSP’s next Distribution Determination takes effect, the transitional included distribution services;c) any new services offered by the DNSP within the period of a Distribution Determination period that meet the definition of a “distribution service” under the National Electricity Rules. <p>“transitional included distribution services” means, for a jurisdiction in which a DNSP’s distribution system is located, the included distribution services listed in Appendix B to this Guideline.</p> <table><tr><td colspan="2">Appendix B</td></tr><tr><td>Jurisdiction</td><td>Transitional included distribution services</td></tr><tr><td>Queensland</td><td>a) all services classified as “non-distribution services” in the Queensland F&A decision</td></tr></table> <p>Note: the term “ring-fenced services” could also be used in place of “distribution services”, to avoid any potential confusion with the NER definition of “distribution services”</p>	Appendix B		Jurisdiction	Transitional included distribution services	Queensland	a) all services classified as “non-distribution services” in the Queensland F&A decision
Appendix B								
Jurisdiction	Transitional included distribution services							
Queensland	a) all services classified as “non-distribution services” in the Queensland F&A decision							
Definition of “energy-related services”	Not defined	“energy-related services” mean electricity services other than distribution services or transmission services, that are provided to end users on a contestable or competitive basis						
3.1 Transitional waivers for “distribution services” legal separation	There is currently no scope for transitional waivers of the legal separation obligation in 3.1	<p>Section 3.1 should be amended to allow for waivers as follows:</p> <p>3.1 Legal separation</p> <ul style="list-style-type: none">a) A DNSP must be a legal entity and, subject to clause 3.1(b) and (e), must only provide distribution services or transmission services.						

		<p>(b) A DNSP may incur costs of up to \$500,000 (identified and allocated in accordance with clause 3.2.2) in any regulatory year for providing services other than distribution or transmission services (excluding any services the subject of a transitional waiver granted in accordance with Section 5).</p> <p>(c) For the avoidance of doubt, clauses 3.1(a) and 3.1(b) do not prevent a related body corporate of a DNSP from providing services other than distribution or transmission services.</p> <p>(d) For the avoidance of doubt, clauses 3.1(a) and 3.1(b) do not prevent a DNSP and a TNSP being the same legal entity.</p> <p>(e) A DNSP may apply for a transitional waiver of the obligations set out in clause (a) in accordance with the waiver process set out in Section 5.</p>								
4.1 General obligations not to discriminate		Amend wording as follows: (a) A DNSP must not discriminate (either directly or indirectly) between its related body corporate (including customers of its related body corporate) and competitors of its related body corporate (including customers of a competitor of its related body corporate) in connection with the provision of distribution services .								
4.3.2 Sharing of Information		A DNSP must ensure that, where commercially valuable information acquired in providing direct control services and/or regulated transmission services (including information derived from that information) is made available to a related body corporate in relation to energy-related services provided by the related body corporate, it is also made available to third parties competing with the related body corporate in relation to the same or similar energy-related services .								
Appendix A – Transitional Arrangements	Currently transition periods of 12 months for clause 3.1(a) and 6 months for clauses 4.2.1 and 4.2.2 are inadequate	<p>Appendix A – Transitional arrangements</p> <p>Despite clause 1.1, the obligations identified in the table below commence on the corresponding date in the table.</p> <table><tr><th>Section</th><th>Commencement Date</th></tr><tr><td>3.2, 4.1(i) – (iv)</td><td>3 months after the commencement date</td></tr><tr><td>3.1, 4.2 and 4.3</td><td><p>a. 12 months after the commencement date</p><p>b. Where a DSNP’s subsequent Distribution Determination results in the reclassification of services, 12 months after the commencement date of the subsequent Distribution Determination in relation to any new obligations arising in relation to those reclassified services.</p></td></tr><tr><td>4.1(v) and (vi) (branding)</td><td><p>a) 18 months after the commencement date</p><p>b) Where a DSNP’s subsequent Distribution Determination results in the reclassification of services, 12 months after the commencement date of the subsequent Distribution Determination in relation to any new obligations arising in relation to those reclassified services.</p></td></tr></table>	Section	Commencement Date	3.2, 4.1(i) – (iv)	3 months after the commencement date	3.1, 4.2 and 4.3	<p>a. 12 months after the commencement date</p> <p>b. Where a DSNP’s subsequent Distribution Determination results in the reclassification of services, 12 months after the commencement date of the subsequent Distribution Determination in relation to any new obligations arising in relation to those reclassified services.</p>	4.1(v) and (vi) (branding)	<p>a) 18 months after the commencement date</p> <p>b) Where a DSNP’s subsequent Distribution Determination results in the reclassification of services, 12 months after the commencement date of the subsequent Distribution Determination in relation to any new obligations arising in relation to those reclassified services.</p>
Section	Commencement Date									
3.2, 4.1(i) – (iv)	3 months after the commencement date									
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4.1(v) and (vi) (branding)	<p>a) 18 months after the commencement date</p> <p>b) Where a DSNP’s subsequent Distribution Determination results in the reclassification of services, 12 months after the commencement date of the subsequent Distribution Determination in relation to any new obligations arising in relation to those reclassified services.</p>									
4.2.2 Staff Sharing	The exceptions available in section	Suggest that sections 4.2.1 and 4.2.2 be reworded as follows:								

	<p>4.2.1 relation to staff sharing should also be available in relation to the restrictions on physical separation/co-location</p>	<p>4.2.1 Physical separation/co-location</p> <ul style="list-style-type: none"> (a) A DNSP must operate physically separate offices for the provision of direct control services and regulated transmission services from the offices from which any of its separate service providers or related bodies corporate provides other energy-related services. For example, a DNSP must operate in physically separate offices, and prevent staff from mixing in the normal course of undertaking work activities. (b) The obligation set out in clause 4.2.1(a) is subject to the following exceptions: <ul style="list-style-type: none"> i. Office accommodation for permitted staff; or ii. Any arrangements agreed through the waiver process set out in Section 5 of this Guideline. <p>4.2.2 Staff sharing</p> <ul style="list-style-type: none"> (a) A DNSP must ensure that its staff directly involved in the provision of a direct control service or a regulated transmission service are not also involved in the provision or marketing of a competitive or contestable energy-related service by a related body corporate. (b) A DNSP must not remunerate or otherwise incentivise its staff (other than a staff member who is a senior executive of both the DNSP and a related body corporate) based on the performance of a related body corporate. <p>4.2.3 Permitted Staff</p> <p>For the purposes of clause 4.2.1 and 4.2.2, the following staff are permitted staff:</p> <ul style="list-style-type: none"> (a) staff of the DNSP's separate service providers or related bodies corporate that are not involved in the provision of energy-related services; (b) a member of staff who is a senior executive of both a DNSP and a related body corporate; or (c) a member of staff who is not directly involved in the provision of any direct control services or regulated transmission services, and who therefore do not have access to information about electricity customers and services, such as staff who exclusively perform corporate services, for example in payroll and human resources; or (d) a member of staff who is involved in the provision of a DNSP's negotiated distribution services and unregulated distribution services; or (e) Any staff authorised through the waiver process set out in Section 5 of this Guideline.
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