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23 September 2019

Ms Sarah Proudfoot  
General Manager, Consumers and Markets Branch  
Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3001

Dear Ms Proudfoot

**Essential Energy submission to the distribution ring-fencing guideline update**

Thank you for the opportunity to provide a submission to the Australian Energy Regulator (AER) consultation on updating the distribution ring-fencing guideline ('the guideline'). We fully support the Energy Networks Australia submission in relation to this matter but provide our own submission to further highlight our specific feedback. In addition, we support the AER's current review of the electricity transmission ring-fencing guideline, which should help align it with the electricity distribution guideline.

Essential Energy recognises that ring-fencing plays an important role in preserving competition for services and in reducing costs for consumers. As such, ring-fencing arrangements should be robust and effective. However, customer outcomes should remain the focus of this regulatory intervention and there are several areas where improvements can be made, particularly in customer experience.

In designing an appropriate ring-fencing regime, care must be taken to avoid imposing unnecessary costs as these are borne by consumers. We encourage the AER to assess the actual harm imposed by breaches of ring-fencing arrangements in order to design a proportionate and efficient regulatory framework. We are concerned that the AER is proposing changes to the ring-fencing guideline that are designed to address perceptions of harm rather than actual negative outcomes for customers.

The national electricity objective requires a consideration of whether a change to the regulatory framework promotes efficiency in the long-term interests of consumers. It is therefore incumbent on market bodies, including the AER, to demonstrate that the benefits to consumers associated with the proposed changes to the guideline outweigh the associated costs.

Finally, the burden of compliance should be carefully considered. We understand that the AER is concerned about the reporting of breaches in a timely manner. More guidance should be provided regarding how a distributor would determine the materiality of breaches of the guideline. If the compliance reporting burden increases significantly as a result of the update of the guideline, the AER should consider whether more time could be provided to report on breaches.

Our response to the specific issues raised by the AER, in the stakeholder workshop held in Sydney on 28 August 2019, is attached to this letter. If you have any questions in relation to this submission, please contact Therese Grace, Regulatory Strategy Manager on (02) 9249 3121 or [therese.grace@essentialenergy.com.au](mailto:therese.grace@essentialenergy.com.au).

Yours sincerely

A handwritten signature in black ink, appearing to read "C Bramley", written over a light grey circular stamp.

Chantelle Bramley  
**General Manager, Strategy, Regulation and Corporate Affairs**

## Essential Energy submission to the distribution ring-fencing guideline update

### General comments

The national electricity objective requires a consideration of whether a change to the regulatory framework promotes efficiency in the long-term interests of consumer. Essential Energy encourages the AER to carefully consider any proposed changes to the ring-fencing guideline ("the guideline") with respect to:

- Efficiency; and
- Customer experience and outcomes.

#### Efficiency

Regulation can impose real costs on energy market participants and these costs are ultimately borne by consumers in the form of higher costs. Therefore, any costs imposed by regulation should be outweighed by associated benefits. In the case of ring-fencing, the administrative costs imposed in complying with the guideline should be outweighed by the benefits of a competitive market for electricity services, i.e. lower costs, greater choice, and better standard of service.

Essential Energy is concerned that the AER has not provided any estimations of the costs associated with the harm caused by Distribution Network Service Providers (DNSPs) not behaving in a pro-competitive manner. Further, it is concerning that the AER appears to be of the view that the perception that a harm could occur is sufficient to impose additional regulatory burden on DNSPs.

There should be a clear distinction between the perception of a harm occurring and actual harm. Only in the latter case would regulatory intervention be warranted.

An example of this, is the proposal to clarify the definition of an office to include shared spaces such as lunchrooms - due to a perception that information may be shared in these venues. This could require some DNSPs to invest in new buildings and facilities at considerable cost to address an unsubstantiated risk.

#### Customer experience and outcomes

The objective of ring-fencing should not be solely to preserve competition. Competition is a means to an end, not an end in itself. Therefore, the impact ring-fencing has on the consumer experience of the energy market and the outcomes for consumers should be the focus of this review.

At the Sydney workshop on this topic, anecdotal evidence was provided that customers are experiencing delays in having electrical work carried out because network businesses are mindful of their ring-fencing obligations and reluctant to provide any advice to customers on who should carry out electrical work. This is leading to delays in having power restored and in some cases may result in safety issues not being resolved in a timely manner. Essential Energy's field staff have also reported a reluctance to provide advice to customers as they are worried about breaching ring-fencing obligations – they will err on the side of caution at the expense of meeting customer expectations.

Essential Energy has first-hand experience of the impact of ring-fencing delays on service delivery to customers. A specific example is where Essential Energy is the provider of last resort for minor service work such as connecting new houses to the network. Customers must attempt to engage an Accredited Service Provider (ASP) in the first instance, but where this is not possible, Essential Energy will then advertise the work on their website and invite ASPs to contact customers directly with a quotation for their services. If, after two weeks the customer has not been contacted by an ASP, then Essential Energy can proceed with the work. In the past 12 months, of the work advertised on Essential Energy's website, only 19% has been undertaken by ASPs. This demonstrates that unnecessary delays are resulting from the ring-fencing guidelines which ultimately have an adverse impact on customer service and experience.

## Response to specific issues raised

### Cost allocation

Essential Energy supports the AER's proposal to provide further clarification on the requirements of the guideline, in respect to how costs are allocated between DNSPs and their affiliates. Concerns were raised at the ring-fencing workshop that DNSPs and their auditors are not understanding the requirement to extend their cost allocation method (CAM) beyond the DNSP. The guideline requires that DNSPs are responsible to account for how costs are allocated between the DNSP and affiliates. This is done by extending the CAM approach to cover cost allocation between the entities.

It should be noted that adherence to accounting standards by DNSPs, in the preparation of their annual accounts and the receipt of an unqualified audit report as well as a satisfactory audit report in relation to annual RINs, should ensure that group allocations to the distribution side of the business are reasonable. Additional audit work should not then be required by an independent assessor for the annual ring-fencing compliance report.

### Functional separation

The AER is concerned that DNSPs have inadequate controls on staff and office sharing and that DNSP staff sharing provisions are too generous. The definition of 'electricity information' is viewed as being potentially too broad and the AER want to ensure that shared staff with 'electricity information' have no opportunity to use it.

Essential Energy supports the suggestion from Energy Networks Australia that the definition of 'electricity information' could be improved by distinguishing between sensitive and non-sensitive 'electricity information'. Sensitive electricity information is usually network or strategic information that will provide an advantage to an affiliate if shared, and non-sensitive 'electricity information' is usually task-specific information that will not provide an advantage to an affiliate if shared.

Energex has provided a staff sharing methodology which identifies which type of electricity information applies to different staff classifications. This could provide a possible basis for deciding which roles are capable of being shared and which should be subject to the guideline.

Following on from this refined definition of electricity information, the definition of office requires further clarification. The guideline provides that DNSPs must use separate offices from an affiliate providing contestable electricity services. There is uncertainty around how this applies to common areas such as kitchens, bathrooms and car parks. Essential Energy would like the definition of office to be amended to ensure that it is confined to areas where work is performed and does not extend to common areas. This will avoid regulating a 'perceived' risk of harm and ensure that unnecessary costs are not incurred when setting up a ring-fenced business. Such costs can inhibit the development of a competitive market for services, particularly in regional areas.

Essential Energy agrees that further clarification should be given on the issue of staff having access to electricity information. The guideline deems a breach to include the circumstance where affiliate staff can access electricity information even if they don't actually access it.

### Compliance reporting

The guideline provides for the submission of an annual compliance report within four months of the end of the regulatory year to which the compliance report relates to. This timing coincides with an already busy period of Regulatory Information Notice (RIN) audits and submission of other compliance reports. Essential Energy would welcome a change to the ring-fencing compliance report being completed based on a calendar year. However, a move to reduce the reporting timeline from four months to three months is not supported.

If reporting is moved to a calendar year basis it is recommended that there is a transitional period whereby after reporting on the financial year to 30 June 2019, the next compliance report would be based on the period 1 July 2019 to 31 December 2020. Without this transitional concession, the cost of re-engaging independent assessors, along with the relative merits of conducting another assessment covering such a short timeframe are likely to make such a transition overly costly for little benefit.

Essential Energy would welcome more clarity on how to define a 'material' breach, as the current guidance is that a breach is material if it is not trivial and is open to different interpretations. If the

expectation is that DNSPs will have to report more breaches, then this increases the compliance burden and consideration should be given to increasing the current requirement of reporting within five business days.

### **Staff and office sharing registers**

Essential Energy agrees that staff and office sharing registers are important for maintaining transparency in ring fencing arrangements. Updating registers on a monthly basis would balance the timeliness of data updates against the regulatory burden of updating on a more regular basis.