



30 May 2016

Mr Chris Pattas  
General Manager, Networks  
Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3001

Dear Mr Pattas

**Submission on the April 2016 *Electricity Ring-Fencing Guideline Preliminary positions paper***

Essential Energy appreciates the opportunity to respond to the Australian Energy Regulator's (AER's) *Electricity Ring-Fencing Guideline Preliminary positions paper* (the proposed guideline). We believe that discrimination, unfair advantage and cross-subsidisation must be eliminated from the contestable market where they are causing, or likely to cause, market harm. As such, we support a national approach to ring-fencing as it will provide certainty and consistency to market participants and should lead to increased competition that will benefit all electricity consumers.

Essential Energy agrees with the objectives of ring-fencing, the alignment to the existing Framework and Approach process and the "service-based" approach put forward in the proposed guideline. However, we do not believe that the proposed "all in and then waiver" approach aligns with the stated objective as it is not linked to any evidence or likelihood of market harm, imposes higher costs across the market, particularly on network service providers (NSPs) and therefore, customers, relative to any achieved benefit and presumes that NSP participation in a contestable market will be anti-competitive by default.

Whilst the AER's proposed guideline is simple on the surface, it is merely transferring the weight of effort into the yet to be determined waiver process. By assuming that each unregulated service provided by a NSP should be subject to ring-fencing, the proposed guideline requires large amounts of time and effort from both NSPs and the AER to undertake and manage an additional waiver process. This will create unnecessary price increases for customers, most of whom will gain absolutely no benefit from the exercise at all.

Instead, we believe a much lighter handed "all-in" approach that makes use of accounting separation in the first instance, coupled with a secondary layer of obligations to be applied on a case-by-case basis *where a real market risk is identified*, would better size ring-fencing obligations to the problem being addressed. It would also ensure the costs of ring-fencing compliance can be clearly assigned to the customers they are benefiting and reduce the imposition of unnecessary costs, arising from the waiver process, on consumers.

In its current form, the proposed guideline is excessively costly and onerous and overlooks the application of existing mechanisms that already provide safeguards against discriminatory, unfair or anti-competitive conduct. NSW entities have complied and operated under the more light handed NSW jurisdictional ring-fencing arrangements for many years. This more proportionate and tailored approach has proven successful, particularly through the development of the NSW competitive Accredited Service Provider market over the same period.

NSPs are not the incumbent provider in any of the emerging markets. At this stage, the exact nature of the economies of scale (synergies) that NSPs may bring to these markets is not well understood and may not emerge until the markets are further developed. Even if synergies do emerge, they may not even create issues as they may:

- Provide market benefits and be pro-competitive;
- Bring perspectives that produce solutions that other participants may overlook;
- Enable NSPs to compete with the large Retailers or with the large, well-resourced global competitors;
- Provide public policy benefits such as identifying and providing solutions for niche markets which other providers may ignore, such as low income households, rental properties or rural locations;
- Allow rural and remote NSPs, like Essential Energy, to implement cheaper, innovative network solutions and emerging technologies that may otherwise be cost-prohibitive if it had to operate under strict ring-fencing requirements including the sharing of staff and premises;
- Allow for innovative solutions to be implemented by NSPs that would otherwise not be viable where the cost of procuring that supply from other market players is more expensive than traditional augmentation options;
- Allow for the continued collection of shared benefits for both distributors and end-users through networks being able to continue to conduct and manage trials of emerging technologies and then use the learnings to commercialise schemes and design tariffs;
- Be in the best interest of consumers as they lead to lower business costs, which translates to lower prices which is in the long term interests of customers.

Imposing disincentives on NSPs may mean they do not enter emerging markets, leaving those markets without the benefit of a class of active competitors. Curtailing the participation of a class of entrants where the market structure, major products and competitors are still uncertain increases the risk of regulatory error and may lead to higher market costs, inefficiencies and lower consumer benefit – factors which would not contribute to the National Electricity Objective (the NEO).

Essential Energy believes that a competitive market should welcome all forms of competitive entry without prejudging the role and benefits of particular competitors. As such, we believe the ring-fencing guidelines must be developed to prevent actual and proven harm, not theoretical speculation.

Essential Energy's responses to the specific questions raised in the guideline are attached to this letter. Should you have any questions on this response, please contact Natalie Lindsay, Manager Network Regulation on 02 6589 8419.

Yours sincerely



Patrick Harsas  
**Chief Financial Officer**

**Question 1: What aspects of current jurisdictional ring-fencing arrangements have or have not worked well?**

Essential Energy has found the NSW jurisdictional ring-fencing measures to be extremely workable and not overly onerous, especially compared to the obligations put forward in the preliminary guideline. This is particularly relevant to our rural network where the costs of the proposed obligations for legal, physical and staff separation would be cost prohibitive to implement for every one of our existing unregulated business activities. This is discussed in more detail in our response to question 6.

The competitive markets in which Essential Energy currently operates that are subject to existing NSW ring-fencing elements are:

**NSW Contestability framework**

The NSW contestability framework has operated effectively for many years and ensures that Accredited Service Providers (ASPs) can compete on a level playing field with NSW distributors. The success of this framework, exemplified through the amount of work which is undertaken by ASPs, provides clear evidence that the perceived economies of scale attributed to NSPs can be effectively managed under a fairly light handed approach to ring-fencing.

On the downside, however, the cost to some rural customers for these services rose once Essential Energy pulled out of the market. Essential Energy's participation in the market either provided economies of scale to customers that more localised ASPs have yet to replicate or another active competitor that helped keep prices down. So whilst the scheme has been successful from an ASP perspective, it has not been successful for customers in terms of prices.

In addition, as the supplier of last resort, Essential Energy still provides connection services in some remote locations where an ASP is not available to do the work. In competitive markets, higher customer density offers more "bang for the buck" as providers can access economies of scale. Once distances become greater and customers more widespread, the cost-to-serve increases and prices either need to rise accordingly or the operator ceases to provide a service in those areas. This is where rural NSP's scale economies really do benefit their customers.

Our experience highlights that a one-size-fits-all approach to the ring-fencing of services may lead to unintended outcomes that are not in the best long term interests of electricity consumers at all. Rural areas with low customer density are particularly vulnerable as they may well be overlooked by service providers.

**Meter contestability**

Essential Energy has successfully operated with other competitors in the contestable metering market for many years.

The current ring-fencing obligations for Essential Energy's unregulated activities are discussed in our response to question 6.

On a more general note, Essential Energy also sees the following regulatory mechanisms in the existing framework as providing safeguards that already support the proposed ring-fencing objectives:

**(i.) Measures to avoid cross-subsidies between regulated and contestable services:****Cost allocation guidelines**

The Cost Allocation Method (CAM), which is approved by the AER, ensures that cost shifting does not occur between different businesses including regulated and unregulated services. Both costs and revenues are allocated on a causation basis in accordance with AER guidelines, ensuring that correct costs are appropriately allocated across each service, preventing networks from distorting market prices and lessening competition. NSPs compliance with the CAM is independently audited each year through the Regulatory Information Notice (RIN) reporting process.

**Shared asset guidelines**

The shared asset guideline ensures that consumers benefit when network assets are used to provide unregulated services. If the total forecast unregulated revenue is expected to be greater than one per cent of the regulated revenue, a cost reduction is applied. This reduces the annual revenue the network requires which lowers prices for customers. Each network provides a list of the unregulated services they provide using shared assets and the total unregulated revenue from those shared assets to the AER. The AER also has the ability to request an overview of the contractual arrangements entered into for unregulated services.

**Expenditure Forecast Assessment Guideline**

The Expenditure Forecast Assessment Guideline outlines the process for the AER's approach to setting efficient expenditure allowances for network businesses. It includes a rigorous and transparent approach to assessing related party costs to ensure they reflect arm's length commercial arrangements.

**(ii.) Measures to avoid discriminatory interactions or unfair advantage:****Regulatory Information Notices (RINs)**

The AER collects information from network businesses via the RINs, at the time of making a regulatory determination and annually during the regulatory period. This data is used by the AER to benchmark businesses' performance against their peers. Non-confidential information is published on the AER website, providing information transparency to any interested stakeholders.

**Other information requirements**

Each NSP is required to publish an annual planning report each year under the National Electricity Rules (NER). The report covers a minimum forward planning period of at least five years and provides an overview of the network, past performance, forecast demand, network constraints and credible network options to manage the constraints. This document provides an opportunity for interested parties to discuss non-network alternative solutions that will alleviate the identified network constraints and the NSP is obliged to consider these non-network solutions as part of its detailed assessment.

Zone substation information and customer access to metering data are also required to be provided on request.

**Regulatory Investment Test – Distribution (RIT-D)**

The RIT-D applies to projects that augment the network and to the replacement of existing infrastructure where that replacement adds capacity to the grid. The purpose of the RIT-D is to set out a process which requires network businesses to consider and consult with stakeholders on non-network alternatives at the beginning of the planning process for major network investments.

**Connection requirements**

Chapter 5 and 5A of the NER set out connection requirements and obligations on both applicants and networks to ensure NSPs provide fair and equal access to customers and do not impose discriminatory connection requirements. The AER approves NSPs' connection policies, standing offers and agreements.

It is also worth mentioning that there are various pieces of legislation under which NSPs could be prosecuted for unfair practices, such as the Competition and Consumer Act 2010. These Acts encourage NSPs to act fairly and ethically, with significant penalties and reputational damage for breaches.

**Question 2:** Do you consider these objectives discussed in section 2.1 adequately reflect the harm ring-fencing is seeking to avoid and the benefits of an even playing field?

Essential Energy largely agrees with the objectives outlined in section 2.1 of the paper. Whilst the paragraph following the objectives discusses the consideration of the costs versus benefits of compliance and a reference to the long-term interests of consumers as defined in the National Electricity Objective (NEO), we think there is benefit in objective 4 being specifically expanded to better encompass these items. For example:

4. in achieving the first three objectives, *consider the costs versus benefits of compliance in promoting an even playing field that may encourage market entry and best satisfy the NEO.*

This will ensure the ring-fencing objectives are considered in the context of not only the long-term interests of electricity consumers, but also the national electricity system as a whole.

**Question 3:** Do you agree with the service classification approach to ring-fencing which is discussed in section 3.3? Is there a better alternative?

Essential Energy agrees with the service based classification approach outlined in section 3.3 of the paper. It aligns with the current NER and, given the dynamic and rapidly evolving emerging markets, we believe this approach best encompasses the markets the guideline is attempting to cover.

In relation to using the Framework & Approach (F&A) paper as the vehicle for revisiting ring-fencing service classifications, we are concerned with the possible consequences if the AER changes a service classification between the F&A paper and the setting of the Final Determination. This could lead to a NSP being nominally in breach of the ring-fencing guideline. NSPs need certainty that the AER would allow an adequate transition period following the Final Determination to comply with the new service classification in these instances.

**Question 4:** Does the proposed approach to ring-fencing adequately deal with the prospects for development of the contestable market for Distributed Energy Resources (DER)?

Essential Energy does not believe that the proposed ring-fencing approach will best deal with the prospects for development of the contestable market for DER. This is because of the presumption that NSP participation in the markets will automatically create an uneven playing field. In the absence of any real market based evidence, we believe this assumption, coupled with the proposed “all-in” approach and the onerous level of ring-fencing obligations outlined in the guideline, will stifle innovation in these markets and lead to NSPs incurring additional, unnecessary costs (that will need to be passed on to customers) that exceed the perceived net benefit for the community.

As such, we believe that the proposed guideline is out of proportion to the issue it is seeking to address and is, therefore, contrary to the COAG Best Practice Regulation guide<sup>1</sup> which states that regulatory processes should be consistent with the following broad principles:

1. Establishing a case for action before addressing a problem. In accordance with the Competition Principles Agreement, legislation should not restrict competition unless it can be demonstrated that the benefits of the restrictions to the community as a whole outweigh the costs and the objectives of the regulation can only be achieved by restricting competition;
2. Considering a range of feasible policy options, including self-regulatory, co-regulatory and non-regulatory approaches, and their benefits and costs assessed. The option adopted should generate the greatest net benefit for the community;

<sup>1</sup> Council of Australian Governments, *Best Practice Regulation, A Guide for Ministerial Councils and National Standard Setting Bodies*, October 2007

3. Ensuring that regulation remains relevant and effective over time. Government action should be effective and proportional to the issue being addressed.

At this stage, it is not clear that the AER has addressed any of these principles in determining the proposed guideline.

That aside, we do support the need for ring-fencing in markets where it is clear that real competition cannot be achieved without imposing such obligations on NSPs, recognising that, even then, the level of ring-fencing obligations may vary by NSP or location and that waivers will still be a necessary requirement. NSPs use DER to comply with licence requirements and manage peak demands. The onerous nature of the proposed ring-fencing obligations, particularly legal, physical and staff separation would be cost prohibitive for a rural network operator, like Essential Energy.

Instead, Essential Energy proposes that the guideline require a very basic, low level ring-fencing obligation in the first instance – the use of accounting separation. A secondary layer could then be applied in instances where there is a threat to a level playing field being achieved and there is a proven net benefit for customers. As proposed in the guideline, this assessment could take place as part of the F&A process. The secondary layer would comprise a suite of possible obligations from which the NSP would propose what it believes to be appropriate measures. These obligations would be reviewed and approved by the AER.

This approach would ensure that ring-fencing obligations are proportionate to the issue they seek to address and would significantly lower administrative costs for both the NSP and the AER. This approach would also be consistent with the COAG Best Practice Regulation Guideline and better serve the NEO by eliminating unnecessary compliance costs that create no net community benefit.

If the AER is not in a position to consider such an approach, then the current proposed guideline and process should:

1. Ensure bulk waivers are in place at the outset to cover NSP services that are not an issue in the contestable market, for example, Night Watch and NBN.
2. Offer a fast-track waiver process that is very quick and simple to cover those more unique network services that are again, not an issue in the contestable market. For example, Essential Energy's water business and Essential Energy's heritage listed Generation assets.
3. Allow all waivers approved under the guideline to continue indefinitely, unless challenged by another market participant. This will save significant amounts of administrative time for NSPs and the AER (and cost to customers) that would otherwise be required every five years.
4. Alter the list of required ring-fencing obligations to a suite of proposed mechanisms from which the AER can select appropriate measures to address the perceived harm. This would allow the solution to be targeted to the NSP's (unique) characteristics and better scaled to the issue it is attempting to resolve in the first instance, rather than applying a one-size-fits-all approach.

Contrary to the proposed guideline, Essential Energy believes that NSPs economies of scale and inclusion in DER markets is generally of real benefit to electricity consumers as:

- **Networks can bring ideas to contestable markets that other providers may overlook**

Take, for example, the creation of the network driven solution for off-peak hot water storage. Customers pay for a hot water storage unit that provides a net benefit to both themselves (through access to much lower off-peak tariffs) and the network (the network controls the load thus, it can cap network demand as required). Off-peak hot water storage units are affordable for customers and provide a much lower overall cost solution than the alternative of augmenting the network. This is an example of a successful network driven solution that works in partnership with customers. Without the participation of NSPs, it is unlikely that this service market would have been created. As such, overly onerous ring-fencing measures may prevent NSPs from successfully competing in similar emerging markets with the real risk that alternative solutions would be more expensive for customers and, therefore, contrary to the NEO.

- **Network participation can provide a low cost outcome that benefits both the customer and the network**

Similar to the hot water storage partnership described above, Essential Energy could work with customers in locations experiencing demand issues to install behind-the-meter storage. The customer benefits from reduced grid consumption and the ability to access off-peak tariffs leading to lower charges. Essential Energy benefits by being able to utilise the storage at times of high network demand. This solution is far less costly than the alternative cost of network augmentation.

Network participation also allows for the continued collection of shared benefits through conducting and managing trials of emerging technologies with customers and then using the learnings to commercialise schemes and design tariffs. For example, both ActewAGL and SA Power Networks have recently announced trials of residential battery storage. The data from the trials will allow better understanding of how such technology impacts customer behaviour and tariff design, whilst also limiting network augmentation.

- **There is certainty for customers that the service provider will still be around to provide maintenance services in years to come**

If a contestable service provider becomes insolvent or ceases operations, the customer will suffer loss if the asset fails. As the supplier of last resort, this also places Essential Energy at a high level of exposure to both:

- Reliability issues if behind-the-meter storage has been aiding network demand
- Possible fines for network supply issues should an off-grid system fail.

As a rural supplier, this is again particularly relevant to Essential Energy. A service provider that only has minimal contractors/staff servicing a large area may take considerable time to address a customer service issue. There could then be additional time delays waiting for spare parts. Allowing NSPs to participate in these markets at least offers networks the opportunity to have some control over the quality of DER equipment and the timeliness and prioritisation of DER maintenance, especially where potential failure of that DER could have adverse implications on the network as a whole.

- **Customers will have access to a service provider, regardless of where they live**

Again, as mentioned in the response to question 1, pockets of NSW have no active ASPs and customers continue to rely on Essential Energy as the provider of last resort. Unfortunately, rural customers are often overlooked when it comes to providing contestable services as the cost-to-serve is increased as a result of the distances involved. In the absence of proven competitive harm, allowing NSPs to compete in DER markets without being subject to overly onerous ring-fencing obligations, will ensure every customer has access to a provider regardless of where they live in the country.

- **NSP inclusion helps keep prices down, especially for rural customers**

Networks offer customers another service provider option and their inclusion may prevent other providers from unnecessarily inflating market prices. As mentioned in the response to question 1, when Essential Energy pulled out of the contestable market following the introduction of the NSW ASP scheme, service prices rose in some areas. This highlights that ring-fencing may lead to adverse customer outcomes, particularly in rural areas with very low levels of competition.

- **There are many other competitors in the DER market with a scale advantage and/or counter-vailing market power that level out the perception of an uneven playing field**

The proposed guideline infers that NSPs have an advantage that would give them an information advantage or somehow allow them to provide a contestable service at a lower cost than other competitors. We don't believe that this is the case as NSPs are required to comply with regulation to provide a swathe of relevant information to the market either annually or as requested (see the response to question 1) and there are other lower cost and simpler ring-fencing measures that could be established to restrict information flows, where appropriate, within the organisation.



In addition, the three large Retailers that now dominate the National Electricity Market with over 75% of customers, have arguably developed their own counter-vailing market power in terms of customer information and a retail relationship which may provide them with significant advantage in DER markets. In some parts of Australia, vertical integration now also prevails between Retail and Generation businesses (Gentailers), with the major Gentailers now providing significant competitive constraint and market power in DER markets too. Further, the DER field comprises many large, well-resourced global competitors that also bring their own scale advantages.

If NSPs are made to suffer onerous ring-fencing obligations that other competitors do not, they may be unable to effectively compete in the market, depriving customers of the choice of another effective service provider. Once again, this is particularly pertinent to rural customers where the cost to serve is higher, meaning these customers are regularly overlooked by other service providers in the competitive market.

**Question 5:** Are there other ring-fencing obligations we should impose on NSPs that provide services into contestable markets?

No. As mentioned in response to question 4, Essential Energy believes the proposed obligations are too onerous, in particular, the requirements for legal, physical and staff separation. Lower cost “Chinese walls” across appropriate parts of the business and the ability to share field staff and premises would be imperative for a rural network, operating in areas of very low customer density, to successfully compete in contestable markets.

As such, the guideline would be better if it included a two stage approach to ring-fencing with a low, base level obligation requiring the use of accounting separation. Then, only in service markets where there is a real threat to the provision of a level playing field or a valid issue has been raised and assessed as harmful by the AER, a secondary layer of scaled obligations should come into play. This approach would eliminate the need for any waivers, saving significant amounts of administrative time for both NSPs and the AER, while not adding costs for customers.

**Question 6:** What costs would be incurred in meeting these obligations?

The proposed obligations would result in an enormous and cost prohibitive increase in both direct and administrative costs at Essential Energy if the affected unregulated services were to be fully ring-fenced. Even the time spent applying for waivers for each of the impacted services would be expected to take considerable staff time, though it is impossible to give an accurate number at this stage given the specifics of the waiver process are not yet known.

In the interests of saving costs to NSPs, the AER and customers, Essential Energy believes, at a minimum, that the following changes should be incorporated into the proposed guideline

- The AER should ensure bulk waivers are in place when the guideline becomes effective for all (generally shared) NSP services that are not subject to active competition in the electricity industry or are required to be undertaken by the NSP by virtue of an existing law; and
- A fast-track waiver process should be developed and in place when the guideline becomes effective for other more unique NSP services that are not the subject of any competitive issues;
- All waivers granted under the guideline should continue indefinitely, unless another market participant raises a concern and an AER review deems that the waiver is no longer appropriate;
- Altering the list of required ring-fencing obligations to a suite of mechanisms from which the AER can select appropriate measures to eliminate the perceived harm. This would allow the solution to be better scaled to the issue it is attempting to resolve in the first instance, rather than applying a one-size-fits-all approach to services and NSPs.



Using the existing unregulated services at Essential Energy that would be impacted by the guideline, we have estimated high level impacts and options we could consider under the guideline and outlined them in the table below. The final column is the suggested approach we would encourage the AER to consider if we had to operate under the proposed guideline.

Unregulated service	Overview of current service	Impact of proposed ring-fencing guideline	Suggested approach
Water business	The water business is impaired and services about 10,000 customers in and around Broken Hill. This service is already partially ring-fenced in that the costs and revenue are separately accounted. Overhead costs are managed through the CAM.	We would need to either: <ul style="list-style-type: none"> <li>Completely ring fence the business. This would require a separate legal entity, the duplication of systems and corporate services including fleet and property, and additional staff members. Given the size of the service and the fact it is impaired, this <b>would be a cost prohibitive undertaking</b>; or</li> <li>Apply for a ring-fencing waiver for this service.</li> </ul>	Fast-track waiver
Metering	This service is already partially ring-fenced in that the costs and revenue are separately accounted. We have been trying to wind this service down for some years. Only a few hundred sites remain and we have contractual obligations to continue servicing those sites until they contract with a new supplier. The remaining sites tend to have either access issues or be outside mobile range so are reliant on a landline service. As such, Retailers and Meter Providers have not been actively pursuing these customers.	We would need to either: <ul style="list-style-type: none"> <li>Completely ring fence the business. This would require a separate legal entity, the duplication of systems and corporate services including fleet and property, and additional staff members. Given the size of the service and the fact we are trying to wind it down, this <b>would be a cost prohibitive undertaking</b>; or</li> <li>Apply for a ring-fencing waiver for this service.</li> </ul>	Fast-track waiver
Generation	Essential Energy is responsible for maintaining several legacy generation assets. Most are old hydro power stations and there are a couple of solar farms. The power stations are all impaired assets and are virtually all decommissioned, but remain as preserved sites under NSW heritage law.	We would need to either: <ul style="list-style-type: none"> <li>Completely ring fence the business. We would need a new legal entity of about three FTEs, associated systems, fleet, equipment and a building in which to house the staff. Given the size of the service and the fact it is impaired, this <b>would be a cost prohibitive undertaking</b>; or</li> <li>Apply for a ring-fencing waiver for this service.</li> </ul>	Fast-track waiver
NBN	Despite this being an unregulated service in AER terms, we are regulated to provide this service under the Telecommunications Act. The Act also dictates that the charges for the service must be fair and reasonable and cover only the incremental costs related to having the service attached to our poles.	We would need to either: <ul style="list-style-type: none"> <li>Completely ring fence the business. Given we cannot determine which poles will be used, we would need to duplicate depots, staff, systems, equipment, vehicles and facilities at ALL existing locations to sufficiently cover the network area. This would be a cost prohibitive exercise and <b>would contravene the Telecommunications Act</b> as our "incremental charges" would then exceed the fair and reasonable requirement; or</li> <li>Apply for a ring-fencing waiver for this service.</li> </ul>	Bulk waiver

Unregulated service	Overview of current service	Impact of proposed ring-fencing guideline	Suggested approach
Night Watch (Night Vision)	We currently separate revenues and project costs in the ledger for this service, but share staff, locations, systems, equipment etc. with the regulated business. Shared costs are managed through the CAM. The service is prevalent across the network so requires adequate resources across all locations.	We would need to either: <ul style="list-style-type: none"> <li>Completely ring fence the business. We would need to duplicate depots, staff, systems, equipment, vehicles and facilities at ALL existing locations to sufficiently cover the network area. This <b>would be cost prohibitive</b>; or</li> <li><b>Cease to provide this service.</b> Bearing in mind it is difficult to see an alternative provider offering this service across our rural and remote network; or</li> <li>Apply for a ring-fencing waiver for this service.</li> </ul>	Bulk waiver
Recoverable works	It is assumed that this relates only to the contestable component of this service and not the recouping of costs for asset damage. We have no obligation to undertake recoverable works given the presence of the NSW ASP scheme. However, in some areas of our network, it can be hard for customers to get an ASP to do the work for them. In this case, as the supplier of last resort, we utilise our qualified field staff. The service has separate revenues and project costs in the ledger, but shares staff, locations, systems, equipment etc. with the regulated business. Shared costs are managed through the CAM.	We would need to either: <ul style="list-style-type: none"> <li>Completely ring fence the business. We would need to duplicate depots, staff, systems, equipment, vehicles and facilities at ALL existing depot locations to sufficiently cover the network area. This <b>would be cost prohibitive</b>; or</li> <li><b>Cease to provide this service.</b> Again, it is difficult to see alternative providers offering this service across <u>all</u> areas of our network; or</li> <li>Apply for a ring-fencing waiver for this service.</li> </ul>	Bulk waiver
Optical fibre network access	Essential Energy leases excess capacity on our optical fibre network. The service has separate revenues and costs in the ledger, but shares staff, locations, systems, equipment etc. with the regulated business. Shared costs are managed through the CAM.	We would need to either: <ul style="list-style-type: none"> <li>Completely ring fence the business. We would need to duplicate depots, staff, systems, equipment, vehicles and facilities at ALL existing depot locations to sufficiently cover the network area. This <b>would be cost prohibitive</b>; or</li> <li><b>Cease to provide this service</b>; or</li> <li>Apply for a ring-fencing waiver for this service.</li> </ul>	Fast-track waiver

At this stage it is impossible to quantify the actual costs that would be incurred under the guideline as there is no certainty as to whether the AER would apply bulk waivers to these services, whether there would be a fast-track waiver process or whether Essential Energy would need to fully re-establish these services as stand-alone businesses. What is clear, however, is that these costs would not be offset by any increase in competition or net benefit to customers.

In the interest of better scaling compliance costs to the size of the problem the guideline is attempting to address, thereby preventing unnecessary increases in customer prices, Essential Energy proposes a simpler two stage ring-fencing approach:

1. A base layer of ring-fencing by way of accounting separation for all unregulated businesses (as is currently operating across most businesses);
2. Where it is shown that there is a real threat to a level playing field being obtained, then a second layer of obligations would apply. These obligations would be suggested by the NSP from a suite of possible mechanisms. The AER would approve the selection, thus ensuring that the obligations are appropriate and commensurate to address the issue at hand. Similar to the proposed guideline, the process of reviewing competition in service markets would take place when developing the F&A paper every five years.

The impact on Essential Energy's existing unregulated services under this approach would be far less costly to all parties.

**Question 7: Should asset sharing be restricted between regulated services and contestable service provision?**

No. Restricting asset sharing would be counter to serving the long-term interests of consumers through the provision of lower electricity prices brought about by sharing network costs. The NEO relates to the efficiency of the entire electricity supply chain, not just the provision of regulated network services. If a NSP can utilise an existing network asset for a contestable service and this avoids the inefficient duplication of assets and functions and saves electricity consumers additional expense, then it satisfies the NEO as being in the long-term interest of consumers.

For example, Essential Energy currently leases excess capacity on our fibre network. This is a small source of revenue for Essential Energy, but the provision of this unregulated services allows us to share the maintenance costs of the network assets and associated business overheads. This is an efficient use of network assets which lowers electricity prices and is, therefore, in the long term interests of consumers and consistent with the NEO.

**Question 8: Do the factors set out above reflect the issues we should consider in deciding whether to grant a ring-fencing waiver?**

As discussed in the responses to the questions above, Essential Energy believes the proposed ring-fencing obligations are too severe in the absence of any proven or likely market harm and that an alternative approach utilising a base layer of accounting separation, with a secondary layer of obligations that could be applied on a case-by-case basis where required, would better address the scale of any perceived problem. This approach would eliminate the need for a waiver process at all.

Alternatively, should the AER find its hands are tied with the current "all-in and then waiver" approach, then Essential Energy sees the ability for NSPs to apply for a waiver as an essential element to be contained in the guideline. This is particularly important given the rural and remote nature of Essential Energy's operating area, meaning that there is often no other service provider available to provide a contestable service.

We agree that the factors set out in the guideline do, broadly, reflect the issues to be considered in deciding whether to grant a ring-fencing waiver. Obviously, we do not yet have visibility of the specific details of the waiver process, but we would welcome the opportunity to work with the AER in developing the associated waiver guideline.

As previously mentioned, we would like to see the bulk waivers operational from the guideline's effective date and the implementation of a fast-track waiver process where it is clear that an unregulated service poses no risk to a level playing field being achieved in the contestable market.

Further, in the interest of saving costs and better meeting the costs versus benefit assessment of ring-fencing compliance, Essential Energy believes all waivers granted under the guideline should continue indefinitely or until another market participant raises a concern with a waiver and it is proven to no longer be appropriate. This is particularly important for rural NSPs who provide contestable services in locations with very low (or even no) levels of competition and for whom the on-going costs associated with managing the approved waivers would merely become an additional overhead cost.

**Question 9: In which circumstances should the customers of ring-fenced services and not customers of the DNSP's services in general pay the additional costs of complying with ring-fencing obligations?**

Ideally, the costs of compliance should be paid for by the customers receiving the benefit. However, the proposed guideline complicates this matter because of its "all-in and then waiver" approach. This means it is necessarily capturing services offered by NSPs that aren't subject to any competitive issues and are currently adequately managed by way of just simple accounting separation. The proposed guideline means Essential Energy will incur costs to satisfy the guideline for these services and the related costs will need to be passed on to customers. Who should pay in this scenario is open

to question, however, as neither the regulated or unregulated customers are gaining any benefit from these compliance costs at all. This is a clear example of why the proposed guideline is out of proportion to the problems it is seeking to address.

A more appropriate guideline would consider the use of accounting separation as an appropriate first layer of ring-fencing for all unregulated services. Only in circumstances where a NSP poses a real threat to competition or a valid issue has been raised and assessed as harmful by the AER would additional ring-fencing obligations be required. These could be selected from a suite of options and tailored to the size of the “problem”. This approach to ring-fencing allows the costs of compliance to be directly related to the service that is being ring-fenced and passed on to the relevant customers.

The proposed guideline will lead to consumers bearing the economic costs of ring-fencing and the associated waiver process. Entities operating under all of the proposed ring-fencing obligations will have higher stand-alone costs than they would otherwise have operating under a more light-handed ring-fencing approach and the use of waivers will add another layer of costs to the process. In reality, it is most likely Standard Control customers who will bear all the costs associated with the proposed guideline’s approach to ring-fencing and the accompanying waiver process. Please refer to our earlier response to question 6 for examples of this.

**Question 10: How else could the AER minimise the administrative cost of ring-fencing while maintaining the integrity of its approach?**

We believe the guideline should be redesigned to have a far less intrusive “all-in” approach with a secondary layer added where necessary. This would significantly reduce compliance costs, better size ring-fencing obligations to the problem being addressed and ensure the costs of ring-fencing compliance can be clearly assigned to the customers they are benefiting. The proposed two parts would be:

1. A base layer of ring-fencing by way of accounting separation for all unregulated businesses (as is currently operating across most businesses);
2. Where it is shown that there is a real threat to a level playing field being obtained, then a second layer of obligations could be suggested by the NSP from a suite of possible mechanisms. The AER would approve the selection, thus ensuring that the obligations are appropriate and commensurate to address the issue at hand. Similar to the proposed guideline, the process of reviewing competition in service markets would take place when developing the F&A paper every five years.

This approach would fully align to COAG’s Best Practice Regulation Guideline and reduce administrative and compliance costs across all parties. Integrity would be obtained by publishing the cost-benefit assessments for each service (and by each NSP where appropriate), including the rationale behind the selection of ring-fencing obligations chosen as being appropriate and commensurate to the address the issue at hand.

If, however, the AER continues with the proposed guideline in its current form, then it must be acknowledged that this will necessarily increase costs for customers above Essential Energy’s proposed alternative (see the table in the response to question 6), and the scale of cost imposition will be much greater than the achievement of any net community benefit across many unregulated services offered by NSPs.

In this instance, we propose that administrative costs could be reduced by:

1. Having bulk waivers in place at the outset to cover those services that are not an issue in the contestable market, for example, Night Watch and NBN.
2. Offering a fast-track waiver process that is very quick and simple to cover those more unique NSP services that are, again, not an issue in the contestable market. For example, Essential Energy’s water business and the heritage listed Generation assets.
3. Allowing all waivers approved under the guideline to continue indefinitely, unless challenged by another market participant. This will save significant amounts of NSP and AER administrative time every five years.

4. Altering the list of required ring-fencing obligations to a suite of possible mechanisms from which the AER can select appropriate measures to eliminate the perceived harm. This would allow the solution to be better scaled to the issue it is attempting to resolve in the first instance, rather than applying a one-size-fits-all approach. These are especially appropriate for rural NSPs for whom the proposed onerous obligations would make competing in contestable markets a cost-prohibitive exercise, potentially depriving some niche customers of a service provider at all, let alone a choice of competitors.

**Question 11:** Is it reasonable for the AER to consider these transitional arrangements to the new ring-fencing guideline?

Yes. As mentioned, we believe the proposed obligations and current “all-in and then waiver” approach are too harsh and that a light-handed, more targeted approach is more appropriate. However, regardless of the form of the final guideline, it is imperative that businesses are given time to implement necessary measures to meet the obligations of the guideline.

**Question 12:** How can we ensure ring-fencing compliance is robust and effective without imposing excessive costs that may ultimately be borne by consumers?

Whilst the AER’s proposed guideline is simple on the surface, it is merely making the yet to be determined waiver process more complex. By incorrectly assuming that each unregulated service provided by a NSP should be subject to ring-fencing, the proposed guideline requires large amounts of time and effort from both NSPs and the AER to undertake and manage an additional waiver process. This will create unnecessary price increases for customers, most of whom will gain absolutely no benefit from the exercise at all.

Essential Energy’s proposed two layer approach to ring-fencing, rather than the assumed “all in” approach in the proposed guideline would achieve the necessary levels of compliance without imposing unnecessary costs on consumers. It will also better size ring-fencing obligations to the problem being addressed and ensure the costs of ring-fencing compliance can be clearly assigned to the customers they are benefiting. Our proposed approach and the alternatives to the current AER proposal are outlined in our response to question 10.