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Dear Mr Pattas

### **Submission on Exposure Draft – Ring Fencing Guidelines**

I refer to the AER's exposure draft of the ring fencing guideline, published on 8 November 2016 (**Exposure Draft Guideline**). We welcome this further opportunity for stakeholders to comment and engage with the AER around development of the Ring Fencing Guideline.

Jemena supports the policy objective of ring fencing – to ensure that network owners cannot use any power associated with control over distribution networks to restrict competition in new or emerging markets at the 'edge' of those networks. At the same time, we reiterate our earlier comments that steps taken to achieve this objective need to be balanced against the cost to network operators, contractors and energy customers associated with ring fencing. In particular, customers will ultimately be worse off if overly broad or inappropriate ring fencing causes customers to miss out on the knowledge, innovation and competition that network service providers can contribute in those markets.

Jemena also supports the submission made by the Energy Networks Australia (**ENA**) in response to the AER's Exposure Draft Guideline, Jemena's submission compliments the matters identified in the ENA's submission.

The AER should not under-estimate the significant impact which the Guideline, once implemented, may have on a wide range of stakeholders other than DNSPs, including contractors, customers and others that operate in this sector.

Given the short consultation period associated with the Exposure Draft Guideline, our comments in this letter are necessarily focused on what we consider to be the most significant issues with the proposed approach.

We've summarised the issues in the table below and expand on each of these in the following attachment.

<p><b>The Exposure Draft Guidelines do not provide a mechanism for large and sophisticated industrial energy customers to “opt out”</b></p>	<ul style="list-style-type: none"> <li>• Sophisticated government and industrial customers have significant size and bargaining power and enjoy a range of options when tendering for work required in relation to complex new connections or other energy activities.</li> <li>• If a customer of this kind prefers that we work collaboratively with other parts of our business to provide an integrated customer solution, the customer should be able to ask us to do so (consistent with the approach adopted by the AER, for example, in relation to a deemed network exemption for these customers).</li> </ul>
<p><b>The non-discrimination provision in clause 4.1 of the Exposure Draft Guideline is broad and highly uncertain.</b></p>	<ul style="list-style-type: none"> <li>• Clause 4.1, as currently drafted, could be read to require a DNSP to control and limit the competitive activities of customers, contractors and a wide range of third parties that are unrelated to it.</li> <li>• Like other regulatory regimes (telco, rail etc.), it is very important that the non-discrimination/ equivalence rule at the heart of the Guideline is precisely defined and appropriately focused.</li> </ul>
<p><b>DNSPs should be able to continue to undertake distribution services which are not subject to competition (e.g. shared access to poles), without the need for waivers</b></p>	<ul style="list-style-type: none"> <li>• The Exposure Draft Guideline places the functional ring fence around “direct control services”. This implicitly suggests that all other distribution services are provided in a competitive market – which is evidently not the case.</li> <li>• The ring fencing provisions need to reflect and distinguish between those parts of a DNSP’s distribution activities that are subject to potential competition from those that are not (i.e. shared access to poles).</li> </ul>
<p><b>There is a risk that the scope of the “staff sharing” rules in clause 4.2.2 could have a significant adverse impact on independent third party service providers</b></p>	<ul style="list-style-type: none"> <li>• Many DNSPs rely on large, independent service contractors (e.g. Service Stream, Jacobs, GHD, Bechtel etc.). The broad definition of “staff” (which includes direct and indirect corporate contractors) may mean that these firms could no longer participate in tender processes to provide ‘arms-length’ services to different parts of the same DNSP group (i.e. they could not work on both sides of the ring fence).</li> <li>• Requiring DNSPs to operate separate panels of service contractors for direct control services from those contractors used for other distribution/energy services would reduce competition for these services, increase network costs – and significantly and adversely impact the market for those services.</li> <li>• If this is required, we submit that the AER should</li> </ul>

	expand its consultation process to include service providers that will be adversely affected.
<b>The waiver process has become more important, but remains highly uncertain.</b>	<ul style="list-style-type: none"> <li>• The significant expansion of ring fencing obligations will mean that DNSPs will need to rely on waivers when investing, managing and structuring parts of their businesses and operations.</li> <li>• DNSPs cannot do this, with confidence, when waivers can be changed at any time by the AER on 40 days' notice – and without any justification or change in circumstances (i.e. at the AER's "absolute discretion").</li> </ul>
<b>The implementation timetable needs to reflect the scale and complexity of the task.</b>	<ul style="list-style-type: none"> <li>• Implementation of significant parts of the Guideline, such as undertaking a review and redesign of internal contracting and (potentially) a restructure of parts of DNSPs' internal accounts, would be required to be implemented within two weeks of this letter.</li> <li>• It is also inconsistent to require new accounting/cost reporting to be implemented (clause 3.2) <u>before</u> the associated changes are required to be made to the corporate structure that supports them (clause 3.1)</li> </ul>

We look forward to continuing to engage with you in this important process and would be happy to meet with AER staff to further discuss our submission, if needed.

If you have any queries in relation to this submission, please contact me on (03) 9173 8231 or by email at [matthew.serpell@jemen.com.au](mailto:matthew.serpell@jemen.com.au).

Yours sincerely,

*[Signed]*

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## KEY JEMENA CONCERNS WITH EXPOSURE DRAFT GUIDELINES

### 1. Large and sophisticated government and industrial energy customers

#### Issue:

As noted in our response to the AER's draft decision, Jemena submits that the Guideline needs to specifically address the position of large government and industrial customers, which often have highly sophisticated network requirements. For example, these customers often require high voltage or specialised infrastructure and equipment to be constructed on their premises on both sides of the connection.

These customers have a range of energy and network choices and a high degree of bargaining power when dealing with potential suppliers, including DNSPs. They run sophisticated tendering arrangements and expect close and collaborative engagement with their network service providers. Such large customers are not likely to be confused, or influenced by, branding.

The AER acknowledges this already, for example, in the Network Exemption Guidelines, which (in both the current and draft replacement Guidelines) have automatic deemed exceptions for "large corporate customers". The 2013 Guideline (at page 10) explains that the "[AER] have recognised that large sophisticated firms may want flexibility when applying for a network exemption. We have added a deemed class for large corporate entities."

This approach reflects the size and bargaining position of large customers. It also enables DNSPs to continue to develop these solutions efficiently and effectively to meet the needs and interests of those large customers whilst also, ensuring network reliability and safety is maintained. This is clearly consistent with the national electricity objective.

#### A proposed solution:

We therefore propose the following clause be introduced to provide this necessary customer flexibility:

### 3 Application to large customers

Section 4 of the Guidelines does not apply to any **distribution service** or other service provided by a **DNSP** or a related body corporate to any of the following:

- (a) a large customer;<sup>1</sup>
- (b) a strata body corporate<sup>2</sup>;
- (c) a government agency;
- (d) a private network operator; or
- (e) any other customer that requests specialised network, connection or technical requirements,

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<sup>1</sup> This term has been used consistently with the current and draft Network Exemption Guidelines.

<sup>2</sup> This term could be defined in the same manner as the term "Body Corporate" under the draft Network Exemption Guidelines.

where the relevant customer has chosen to deal directly with the DNSP and/or any related body corporate in respect of the relevant service(s) and has elected in writing to waive the requirements of section 4 of this Guideline.

## 2. Non discrimination

### Issue:

Jemena had previously noted the importance of having a well framed and targeted non-discrimination principle – to avoid the final Guideline from inadvertently restricting competition. However, as currently framed, clause 4.1 is highly uncertain and it is not entirely clear what the AER is trying to achieve.

For example:

- The new drafting of “affiliated entity” means that DNSPs are required to treat customers of the affiliated entity as though they were related entities. Read strictly, this would mean that a DNSP is required to deal with the affiliated entity customers. In essence the Guideline ask the DNSP to have some element of control over individuals and organisations that it may not have any contact with or are significantly distant from the operations of the DNSP. Such control will also have inadvertently impact on other markets, including the market for the provision of services to the DNSP.
- The second limb of clause 4.1(b) now provides that DNSPs must not discriminate (including ‘indirectly?’) ... in connection with the provision of ... distribution services by any other party. It is not clear how a DNSP is able to control the supply of services by all third parties that use its network, to ensure that there is no discrimination between customers of that third party.

In both cases, the operation of the clause is confusing and appears to be an attempt to make DNSPs responsible for the market conduct of unrelated third parties.

Jemena submits that any non-discrimination obligation needs to be focused on identifying the monopoly network ‘input’ – and preventing the owner from favouring its own downstream activities relative to competitors in relation to the supply of that input. A non-discrimination obligation is not a means for seeking to make DNSPs responsible for how unrelated customers or third parties operate in downstream markets.

Jemena also notes that, in many cases, discrimination between different products or customers is fair and pro-competitive (see, for example, the pricing principles in Section 44ZZCA of the CCA). It cannot be the intention of the AER to prevent this kind of welfare-enhancing behaviour and so, we submit, any restriction on discrimination needs to be limited to “unfair” behaviour.

### A proposed solution:

We would be pleased to discuss the approach to this clause further with the AER, and what was sought to be achieved by the current drafting, but at present we propose the following alternative:

#### **4.1 Obligation not to discriminate**

A **DNSP** must not unfairly discriminate in the supply of a **distribution service** as between:

- (a) an **affiliated entity**, where the **distribution service** is used in the provision by that **affiliated entity** of an **electricity service**; and

- (b) any other person engaged in the provision of that **electricity service** in competition with the **affiliated entity**.

Where the term “affiliated entity” is given the meaning set out in clause 1.4 (Definitions) and the extended definition under clause 4.1(a) is removed.

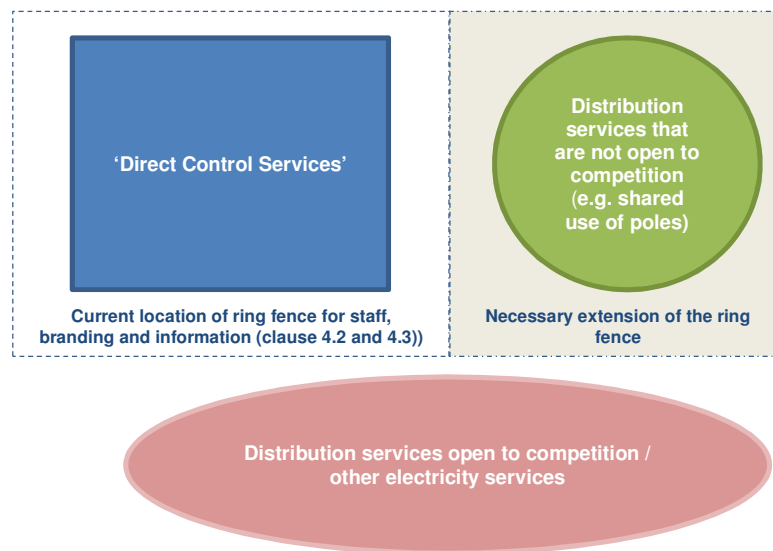
### 3. Scope of the services that are ‘ring fenced’

#### Issue:

Jemena acknowledges the updated approach reflected in the Exposure Draft Guidelines, which now permits DNSPs to supply ‘distribution services’.

However, the functional separation provisions governing staff, branding and confidential information continue to place the ring fence around a narrow category of “direct control services”. In practice, this would require DNSPs to physically separate staff, branding and information associated with the provision of a range of distribution services that are not subject to competition, but which are not DCS and so fall outside the ring fence.

A simplified outline of our concern is set out below:



#### A proposed solution:

As this diagram highlights, when defining the location of the functional ring fence, the Guideline needs to distinguish between distribution services that are open to competition (and so need to be outside the ring fence) from those that are not.

We submit that this could be achieved by replacing references to “direct control services” in clause 4.2 with a slightly wider concept of “**ring-fenced distribution services**”, which is then targeted at those network activities undertaken by a DNSP which are not able to be supplied by others. We suggest drafting along the lines of the following:

“**ring-fenced distribution services**” means:

- (a) direct control services; and
- (b) any other distribution services for which the DNSP is the only actual or potential supplier, in respect of that DNSP’s distribution network.



#### **4. Impact of the Guideline on independent service providers market**

Issue:

As the AER is aware, the electricity industry relies heavily upon a range of large, independent service providers (e.g. Service Stream, GHD, Bechtel, Jacobs Engineering).

DNSPs retain panels of these contractors and commonly undertake tender processes to appoint them. These contractors are then used for a range of activities – including both direct control services and other distribution services.

The definition of “staff” in the Exposure Draft Guideline is very broad and extends this concept to include all “*direct or indirect contractors to the entity (whether the contractors are individuals or corporate or other entities)*”. When applied under the staff sharing restrictions in clause 4.2.2(a), this would appear to mean that a DNSP must establish and use an entirely separate panel of contractors for its direct control services from other services. As well as significantly reducing competition in tender processes (which will drive up network costs for consumers), this is likely to be highly disruptive for existing contractors already on DNSP panels and the market for these services more generally.

A proposed solution:

We recommend that this risk could be addressed by narrowing the currently proposed definition of “staff” to only address individual contractors performing the functions or roles ordinarily performed by staff of a DNSP (i.e. where their day to day performance is controlled by the DNSP) and that the restriction only applies for the duration of the engagement and does not impact the ability of those contractors to undertake work for other entities in the market after the engagement has been completed.

## 5. The waiver process is highly uncertain

### Issue:

Jemena welcomes the amendments made in the Exposure Draft Guideline to increase the scope of the obligations for which waivers are potentially available.

As noted in our earlier submission, the task of implementing ring fencing is complex and cannot be imposed in a rigid or 'one size fits all' manner without seriously and adversely affecting efficiency and consumer outcomes, as well as potentially network safety and reliability.

Experience under state jurisdictional guidelines as well as in other sectors has highlighted the important role of waivers – and the wide scope and complexity of the new Guideline is likely to make them even more important.

Where a DNSP seeks a waiver, it is likely that it will be investing significantly in reliance on the waiver – including potentially in relation to the way it structures its business and network operations. In this context, it is not reasonable for a waiver to be able to be varied or removed by the AER within 40 days (clause 5.5), with very limited detail around any review or consultation processes. This contrasts, for example, with the process for implementing a decision by the AER to amend the classification of distribution services supplied by a DNSP (under clause 7.1(b)), which allows 12 months for the DNSP to implement changes.

Similarly, the AER remains free to vary or revoke a waiver at its “absolute discretion”. This contrasts with other similar statutory frameworks, where regulators are not able to revoke or vary prior undertakings or waivers, unless circumstances change that justify this. See, for example, the limitations on the ability of the ACCC to revoke an authorisation under section 91B of the Competition and Consumer Act, which requires the ACCC to be satisfied that there has been a “material change in circumstances” since it was granted.

Jemena considers the very short time frame in which waivers are reviewed increases risk and cost to the business, but could also adversely affect a customer as they may be forced to source services from an alternative provider but may not be able to do so in the limited timeframes they are faced with.

### A proposed solution

Recognising the need for DNSPs to have confidence in waivers in order to invest and restructure their operations, the waiver process in clause 5 should be amended to provide greater certainty for DNSPs as follows:

- A minimum level of consultation with the DNSP should be specified prior to any variation or revocation.
- Any variation or removal of a waiver should not be at the “absolute discretion” of the AER, but must only be undertaken where a material change in circumstances means that the waiver no longer satisfies the requirements in 5.3.2(a).
- The implementation period for any revocation or variation of a waiver should be 12 months – consistent with the implementation period allowed if the AER

changes a distribution determination in a way that impacts compliance with the Guideline.

## 6. Implementation timing

While some ring fencing obligations have had implementation delayed to 2018, significant parts of the Exposure Draft Guideline still commence on 1 December 2016, approximately two weeks from the date of this response.

This does not give DNSPs time to even seek interim waivers, if they were available (which, for a number of relevant obligations, they are not). As a practical matter, there is simply no time to undertake any meaningful compliance audit or additional training before the implementation date.

There is also internal inconsistency in the approach adopted to implementation in the Exposure Draft Guideline. For example:

- DNSPs have been given 12 months (until 1 January 2018) to put in place any new corporate structure (under clause 3.1), but they are required to start preparing internal reports and cost accounting in relation to this structure immediately (under clause 3.2).
- DNSPs have 12 months to implement any necessary staff separation and rebranding within its business or corporate group – but other elements which are also highly complex (such as IT separation and the potential introduction of “internal contracts”) must be in place by 1 December 2016.

Jemena is concerned that this timetable is inconsistent and wholly unrealistic and therefore gives rise to a significant compliance risk and cost for DNSPs.

### A proposed solution

The implementation date for the Guideline should be 1 July 2017 for all obligations.