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Mr Chris Pattas
General Manager, Networks
Australian Energy Regulator
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Dear Mr Pattas,

Re: Ring fencing guideline

We welcome the opportunity to respond to the Australian Energy Regulator's (AER's) preliminary positions paper (**paper**) on the ring-fencing guideline (**guideline**). We also appreciated the opportunity to discuss this paper with AER staff recently, and welcome further opportunities to do so as the AER works towards its draft guideline.

Jemena has a strong interest in and experience with ring-fencing, given our diversified portfolio of regulated and unregulated services across electricity distribution, gas distribution and transmission, and water assets. Providing safe, reliable and efficient energy supply services across these industries requires Jemena to (among other things) comply with a number of existing ring-fencing arrangements, including anti-competitive provisions in the Competition and Consumer Act 2010. These arrangements also govern how we interact with service providers with common ownership.

Ring-fencing is important

We recognise that ring-fencing plays an important role, both in protecting customers from harm and in signalling to stakeholders that there are protections in place. We also recognise that it is important to balance any potential harm against benefits, ensuring that it is the customers' long-term interests that remain paramount when assessing what ring-fencing obligations should apply.

To this end, we put our support behind the Energy Network Association's (ENA) submission on the paper. It takes a principled and pragmatic approach to dealing with complex issues, in a way that places these long-term interests at the forefront of the regulatory design process.

Our submission adds to the ENA's by making five points:

1. Ring-fencing obligations should be proportionate to the harm—this is consistent with good regulatory practice
2. The waiver process needs to be clear—this will let stakeholders better engage with what is being proposed
3. Ring-fencing obligations should not extend to separation of economic interests—to do so would likely harm customers

4. Ring-fencing should not conflict with the shared asset guideline—as this would also likely harm customers
5. Ring-fencing should not discourage market development—as there are clear customer benefits from allowing networks to innovate.

1. Ring-fencing obligations should be proportionate to the harm

The proposed approach (in the paper) starts by ensuring that all contestable services provided by network service providers (**NSPs**) are ring-fenced, and then allowing for exceptions to this via a waiver process.

Our concern with this approach is that it assumes that NSP participation in contestable emerging markets is harmful to customers as a starting point, even though this is not proven. This approach is also a significant departure from the current jurisdictional ring-fencing arrangements, without a clear basis for doing so. There is no evidence that we are aware of that shows that these current arrangements are broken or causing harm to customers.

We are particularly concerned that it may unfairly interfere with existing services provided to customers. For instance, Jemena Electricity Networks (Vic) Ltd (**JEN**) currently provides a range of contestable and negotiated services in Victoria, including:

- **Negotiated services**—such as new public lighting services (for greenfield sites), altering and relocating public lighting assets, and constructing reserve feeders
- **Unregulated services**—such as joint use of poles and SCADA (sharing fibre optic network), providing watchman lighting services, and emergency recoverable works.

At first glance, JEN would be restricted from providing these services under the proposed approach. The waiver process may provide exceptions for these services—and should do so if the approach is retained—but there is a cost to this (in terms of applying for waivers) and it is unclear how this process will work in practice.

2. The waiver process needs to be clearer

All this says that understanding the waiver process is essential to understanding the AER's proposed ring-fencing approach—which is something we cannot do at this stage.

We recognise that the AER intends to issue a technical paper on the waiver process and engage with stakeholders further on it, and this is an important step. However, it is also important that the guideline clearly articulate how the waiver process will work, including:

- How it will be administered (e.g. process for applying, evidence needed, timelines, AER resourcing, requirement for public consultation)
- How commercially sensitive information will be protected (which is essential for new services)
- How it overlaps with the framework and approach

- How the AER will make decisions and whether there is an opportunity for review of these.

3. Ring-fencing obligations should not extend to separation of economic interests

The paper refers to ‘structural separation’, but does not clearly define this term. We are concerned that stakeholders may misinterpret the paper as saying that separation of economic interests is required to protect customers’ interests, but that the AER cannot enforce this using its existing powers.

The guideline should make it clear that this not the case, by:

- Defining what is meant by ‘structural separation’, and
- Confirming that separation of economic interests goes beyond the scope of ring-fencing (and the guideline specifically).

This is both consistent with what is allowed under the National Electricity Rules,¹ and with views expressed by the ACCC:²

Structural separation requires that the monopoly service provider and the competitive upstream and/or downstream operations be completely separate entities with no overlapping economic interests. Full structural separation goes beyond ring-fencing type arrangements and removes the vertical integration all together.

It also makes good economic sense (to allow common ownership). Customers benefit from common ownership through the sharing of support services and the like due to economies of scale and scope. Effective and fair cost allocation and restrictions on access to sensitive information ensure that this sharing does not harm customers, and this should be the focus of ring-fencing. Any more and customers would likely end up worse off—as network costs increase to offset lost economies of scale and scope.

4. Ring-fencing should not conflict with the shared asset guideline

Similarly, our customers benefit from assets being shared between regulated and unregulated services (e.g. joint use of poles). This sharing avoids duplication of assets, with revenue or costs being shared amongst both sets of services to lower customers’ bills.

If the ring-fencing guideline is overly onerous, then there is a real risk that our customers will no longer benefit from asset sharing. The guideline should avoid this risk, ensuring that it is designed to sit alongside the shared assets guideline.

5. Ring-fencing should not discourage market development

Finally, customers also benefit from innovation initiated by networks (e.g. Jemena web portal provides access to interval data, in-home displays to monitor usage in real-time, demand management solutions to defer augmentation costs). The guideline should be developed in a way that does not stifle such

¹ NER, Ch 6, Cl. 6.17.2(a)

² ACCC, Draft Part IIIA access undertaking guidelines, May 2016.

innovations, and should recognise that the scale offered by networks can be used to provide customers with real benefits.

Customers will ultimately drive an evolving market structure, gravitating over time to providers that offer the best value-for-money. The provider that can deliver product reliability and innovation at a relatively low cost of capital will likely succeed—and this may go in cycles as new technology and brands emerge.

The guideline should not create barriers to entry for other 'logical' market players, like NSPs. Imposing a heavy-handed ring-fencing guideline similar to the separation currently proposed in the guideline, becomes disproportionate to the problem being solved and has unintended consequences of removing players that should be in the market.

We are concerned that the waiver process outlined in the paper may, once clarified, create such barriers (and stifle innovation rather than promote) and encourage the AER to consider this risk. We look forward to seeing how the draft guideline seeks to promote innovation and customer interest.

If you wish to discuss our submission further, please contact Thomas Allen on (03) 9173 8654 or at Thomas.Allen@Jemena.com.au.

Best regards,



Eli Grace-Webb
General Manager Regulation (acting)