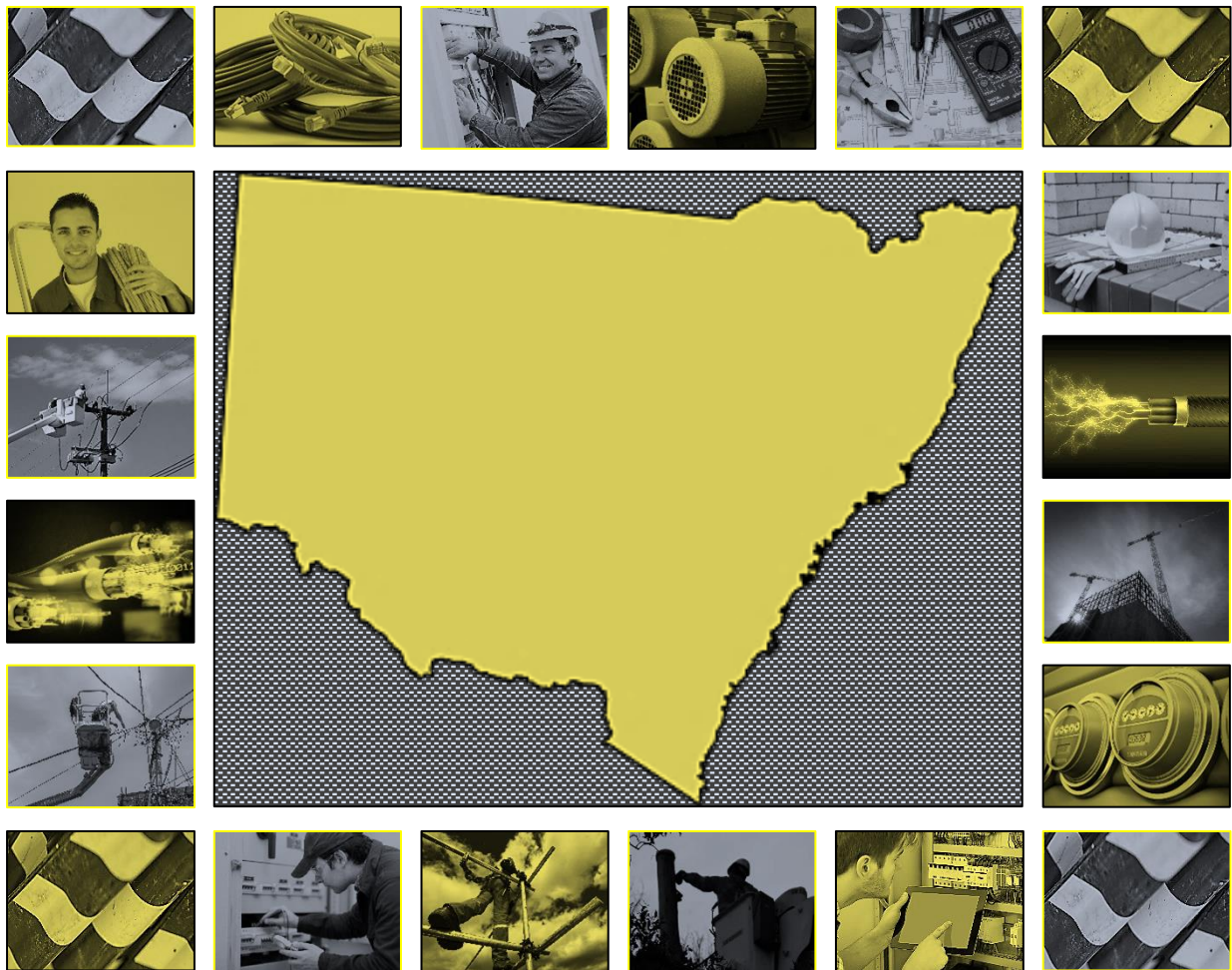


# NECA submission on the draft amendments to the Ring Fencing Guideline



August 2017

## About NECA

The National Electrical and Communications Association (NECA) is the peak industry body for Australia's electrical and communications contracting industry, which employs more than 145,000 workers and delivers an annual turnover in excess of \$23 billion. We represent approximately 4,000 electrical contracting businesses across Australia.

NECA represents the electrical and communications contracting industry across all states and territories. As a result of NECA's bi-annual industry survey, we are aware that NSW is the chosen headquartered state for many of the larger electrical contractors, making NSW issues critical for our members and the industry at large.

NECA aims to help our members and the wider industry to operate and manage their business more effectively and efficiently. To this end, NECA NSW owns and operates a Group Training Organisation, Registered Training Organisation, and its own Law Firm which all provide valued and industry focussed services to our members.

NECA represents members' interests to Federal and State Governments, regulators and principal industry bodies such as the Australian Chamber of Commerce and Industry (ACCI) and Standards Australia.

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## Foreward

NECA is supportive of the overall approach outlined by the Australian Electricity Regulator (AER) in the draft Ring-Fencing Guideline, which we consider will enhance the rigour and transparency of the ring-fencing of DNSPs and their related service providers.

We also appreciate that the AER states that the Guideline amendment process is only intended to address the need for improved clarity and to address unintended consequences stemming from the way the Guideline is presently drafted.

However, there are still a number of issues which our accredited service providers (ASP) members in NSW would like the AER to consider and address.

These include concerns with respect to:

- Accounting systems should capture the full – as opposed to incremental – costs of DNSPs' Commercial Businesses;
- Discriminatory access to procurement contracts and stock and the unfair advantage it may bring to DNSPs' Commercial Businesses;
- Branding;
- Staff Sharing;
- Providing subsidies through uncompetitive tendering practices; and
- Enforcement mechanisms and procedures.

Additionally, NECA would appreciate it if the AER could spell out what evidence we should seek to elicit from our members, in order to inform the AER's deliberations going forward in relation to the efficacy of the Guideline. I would be happy to discuss further and can be contacted on telephone: 02 9439 8523 or email: [suresh.manickam@neca.asn.au](mailto:suresh.manickam@neca.asn.au)

Yours faithfully



Suresh Manickam  
**Chief Executive Officer**  
**National Electrical and Communications Association (NECA)**

## Definitions

For clarity, the following terms are used in the remainder of this document:

- *DNSP Monopoly Business* to describe that part of the DNSP business which owns the assets and provides regulated, monopoly services;
- *DNSP Commercial Business* to describe that part of the DNSP business that competes openly in the marketplace; which can include contestable works as an ASP or other private works; and
- *ASP* to describe a private Accredited Service Provider but can extend to any third party company that is competing against the DNSP Commercial Business in the marketplace.

## Fully capturing costs

NECA advocates that the accounting systems of a DNSP Commercial Business should capture the *full* costs of services and products provided to it by the DNSP Monopoly Business, not merely the *incremental* costs associated with providing them to DNSP Commercial Businesses in addition to DNSP Monopoly Business.

In other words, the Ring Fencing Guideline needs to be ensure that the overheads of the DNSP Commercial Business's IT systems, plant and equipment etcetera are all hypothecated in full to the DNSP Commercial Business to reflect the total cost.

Additionally, this should extended to include the full cost of the labour utilised by the DNSP Commercial Business being allocated to the projects for which they are competing with ASPs. This includes labour costs such as training etcetera.

With reference to Clause 4.2.2(b), NECA submits that in order to maintain a truly ringfenced commercial business and to promote fair competition with commercial ASP companies, the DNSP Commercial Business *must* be required to employ their own stand-alone staff engaged solely for the purpose of the DNSP Commercial Business (with the exception of an emergency situation).

Such staff may include but not be limited to:

- All General Administration;
- Accounting;
- Payroll;
- Human Resources;
- Legal and / or Regulatory;
- Information Technology;
- Project Management;
- Tendering;
- Contract Management; and
- Service Delivery.

Further, NECA submits that this extends to the CRM, ERP / Payroll systems to ensure that there is true ringfencing of staff and fair competition in the marketplace.

This will ensure that the provisions contained in the Ring Fencing Guideline are putting the DNSP Commercial Businesses and ASPs on a genuinely equal footing.

## Discriminatory access to procurement contracts and stock

NECA believes that the Ring-Fencing Guideline still does not adequately address the issue of material purchasing and the unfair advantage it may bestow on the DNSP Commercial Business.

Clarification should therefore be provided in the Guideline that ring fencing should apply to the supply of goods, as the same cross-subsidies exist within the DNSP businesses in relation to the supply of goods to the external market as occur with the supply of services to the external market.

Therefore, as the on-selling of materials is a form of unregulated income, the same functional and financial separation (including branding) should be applied to the supply of goods by the DNSPs as well as services. Otherwise, there is the danger that the Guideline will entrench inconsistency.

A DNSP Monopoly Business has well established procurement and logistic infrastructure that supports its monopoly activities of capital, maintenance and breakdown works. DNSP Monopoly Businesses obtain very competitive pricing as a result of the significant volumes of their purchases. Such pricing then provides an unfair advantage to the DNSP business when they on-sell materials (including to their own DNSP Commercial Business when competing against external contractors).

The fact that DNSPs hold significant stock also provides them a significant advantage in meeting manufacturer minimum order quantities (MOQ) and reducing lead times when on-selling. Additionally, the DNSP Commercial Business can take advantage of this “availability of stock” and purchasing power compared to an ASP, who may have to wait up to 12 weeks for delivery of certain items such as cables, transformers and switchgear. This immediate availability provides the DNSP Commercial Business with an unfair advantage.

The DNSP Monopoly Business controls the approval process of materials and typically link product approval to success in the tendering process. In many cases, only one supplier is approved with previous suppliers having their approvals revoked. This creates a monopoly by restricting other manufacturers from supplying their goods into the ASP market, even though their product may be technically compliant.



The successful supplier may favour the DNSP in order to maintain approvals and its preferred supplier status; and the supplier does not discriminate between the DNSP Monopoly Business and the DNS Commercial Business. Examples of favouritism include providing priority for manufacturing or material delivery to a DNSP at the expense of or delay to an ASP. This exposes the ASP to commercial risks such as liquidated damages, delay costs and other non-recoverable expenses outside the control of the ASP.

Where the DNSP Monopoly Business changes standards or removes the approval of an item, the DNSP is still able to deplete their existing stock or have commercial arrangements in place to be reimbursed by the supplier for non-conforming stock. An ASP does not have the ability to return or deplete stock levels for obsolete items, thus incurring financial penalty.

Further, as many DNSP approvals create a monopoly of supply, ASPs are in weakened bargaining position and are unable to negotiate as favourable commercial arrangements with suppliers. This provides an unfair advantage to the DNSP Commercial Business.

NECA therefore submits that the:

- DNSP Commercial Business should not be able to take advantage of the material supply or other service contracts negotiated by the DNSP Monopoly Business;
- The DNSP Commercial Business should not have access to the warehousing facilities and goods receiving / dispatch functions of the DNSP Monopoly Business;
- DNSP Commercial Business should not have access to the stock held by the DNSP Monopoly Business; and
- DNSP Monopoly Businesses have a policy that more than one supplier of a product be approved wherever possible.

We believe that Section 4 Functional separation of the Ring-fencing Guideline should be amended and / or interpreted in order to ensure that these measures take place in practice.

## Branding

NECA believes that the Ring-Fencing Guideline should incorporate additional requirements such as mandating a separate phone number, website, email addresses and switchboard between the DNSP Monopoly Business and DNSP Commercial Business to avoid inadvertent or intentional transfers between businesses.

This will help ensure that the spirit of the Ring Fencing Guideline is translated into practice.

## Staff sharing

As previously stated, with reference to Clause 4.2.2(b) NECA submits that in order to maintain a truly ringfenced commercial business and to promote fair competition with commercial ASP companies, the DNSP Commercial Business must be required to employ their own standalone staff engaged solely for the purpose of the DNSP Commercial Business (with the exception of an emergency situation).

Such staff may include but not be limited to:

- All General Administration;
- Accounting;
- Payroll;
- Human Resources;
- Legal and / or Regulatory;
- Information Technology;
- Project Management;
- Tendering;
- Contract Management; and
- Service Delivery.

Further, NECA submits that this extends to the CRM, ERP / Payroll systems to ensure that there is true ringfencing of staff and fair competition in the marketplace.

## Providing subsidies through uncompetitive tendering practices

NECA believes that the Ring-Fencing Guideline does not adequately address cross subsidies that can occur through uncompetitive tendering practices.

The DNSP Commercial Business may provide services to the DNSP Monopoly Business. Services may include the provision of labour, materials, plant, vehicles, design, construction or maintenance. Unless such services have been openly and transparently tendered in the marketplace, there is the very real perception that such work would be cross subsidising the DNSP Commercial Business. In fact, such work may make the DNSP Commercial Business viable regardless of its success in undertaking ASP or private works.

NECA submits that any works provided or payments made by the DNSP Monopoly Business to the DNSP Commercial Business:

- Be no more than \$500,000 per annum as suggested in the Ring-Fencing Guideline;
- Must be in accordance with a written contract that has been openly and transparently tendered;
- Have the same contract conditions imposed and enforced as if an ASP provided such services;
- Be entered into a publicly available tender register; and
- Be subject to probity and third party audit with mandatory reporting to the AER.

## Enforcement

NECA understands that the Ring-Fencing Guidelines proposes to use the court system as a mechanism of enforcement in the event of a breach.

NECA seeks clarity on how this would work. Specifically:

- Are the Ring-Fencing Guidelines enforceable or are the National Electricity Rules enforceable? It is understood that the Guideline has greater detail on the mechanisms for ring-fencing, but it is only a guideline. Does the Guideline carry the same weight as the Rules?
- Who will bring the breach to court? Can this only be done by the AER or can anyone bring the breach to court?
- Will the AER have the resources and funding to proactively investigate and prosecute any breaches?
- The DNSP can damage an ASP and the market but there is no damage specifically to the AER. So how will damages be applied by the court and the AER? As an example, the DNSP may unfairly win a project for \$10 million dollars that has deprived the market of such work, but damages cannot be attributable to any one ASP. Will the DNSP be allowed to complete the works? Will damages be applied to the DNSP?

Due the lack of clarity with enforcement and the difficulty in quantifying damages as a result of a breach through a civil court, NECA submits that the AER should investigate a penalty mechanism for breaches rather than simply relying on a court judgment.

Moreover, recourse to the courts may lead to lessened certainty, greater delays and higher costs for all market participants.

NECA members have also proposed that the position of an independent Electrical Industry Ombudsman be established, who is charged with proactively ensuring that industry participants are treated fairly according to the relevant legislation.

## Gathering evidence going forward

NECA would appreciate it if the AER could spell out what evidence we should seek to elicit from our members, in order to inform the AER's deliberations going forward in relation to the efficacy of the Guideline.

If specific examples or explanation of ASPs being disadvantaged by the behaviour of DNSPs would be beneficial, NECA is happy to bring a select small group of our ASP members to the AER for discussions.