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28 September 2016

Mr Chris Pattas  
General Manager Network Pricing, Policy and Compliance Branch  
Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3001

Submitted via email: [Ringfencingguideline2016@aer.gov.au](mailto:Ringfencingguideline2016@aer.gov.au)

Dear Chris

## **Re: AER Draft Ring-Fencing Guideline Electricity Distribution**

### **1. Summary**

Red Energy (Red) and Lumo Energy (Lumo) welcome the opportunity to make a submission to the Australian Energy Regulator's (AER's) Draft Electricity Ring-Fencing Guideline Electricity Distribution (Draft Guideline).

Red and Lumo are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria and New South Wales and electricity in South Australia and Queensland to over 1 million customers.

We are members of the Australian Energy Council (AEC) and support the positions in the AEC submission.

Red and Lumo strongly support the AER's Draft Guideline. More specifically, we support the requirement for Distribution Network Service Providers (DNSPs) to:

- provide non-distribution services through an independent legal entity without the ability to apply for a waiver to this requirement. However we do not support the \$500,000 threshold that would allow DNSPs to directly provide non-distribution services up to this threshold.
- explicitly restrict the allocation of distribution services costs that properly relate to non-distribution services. This clear prohibition is necessary because the current cost allocation principles that apply to DNSPs under rule 6.15 of the National Electricity Rules (NER) only apply to the attribution and allocation of costs between distribution services (i.e. not between distribution and non-distribution services).
- maintain consolidated and separate accounts for standard control services, alternative control services and other services provided by them without the right to apply for a waiver to this requirement. This includes the additional requirement for DNSPs to maintain appropriate internal accounting procedures that would highlight the nature of any transactions between it and related bodies corporate.
- comply with the general obligation not to discriminate between its related bodies corporate and competitors of those entities without the ability to apply for a waiver to this requirement. In addition, we support provisions that apply to:
  - functional separation that requires the physical separation of a DNSPs' offices from its service providers or related bodies corporate;

- separation of staff providing DNSP services from those providing non regulated services;
- information access and disclosure.
- restrict the application of ring-fencing waivers to the functional separation of either accommodation and or/employees. We support the decision that does not permit the core ring-fencing obligations of legal separation, cost allocation and information protection to be waived.
- comply with the ring-fencing guidelines through a robust compliance regime which incorporates a strong level of monitoring and reporting.

All of these changes will help to ensure that the market for Behind the Meter (BTM) contestable energy services develop in a competitively neutral manner providing long term benefits to consumers. As such, they are consistent with the National Electricity Objective (NEO).

## **2. Cross subsidisation**

### **2.1. Legal separation**

Red and Lumo support the decision to restrict DNSPs to providing distribution services. Whilst allowing a DNSP related body corporate would still be permitted to supply non-distribution services if it so desired.

The decision to prevent a DNSP from directly supplying non-distribution services is critical. This is due to the fact that sole reliance on separate cost allocation and accounting in itself would not prevent cross subsidisation.

The AER does not currently have the power to require a DNSP's Cost Allocation Methodology (CAM) developed under the Cost Allocation Guideline to reflect the allocation of costs to non-distribution services. This makes it even more important that DNSPs are restricted to supplying non-distribution services through a separate legal entity.

### **2.2. Materiality threshold**

Red and Lumo do not support the proposed \$500,000 threshold that would allow DNSPs to provide some limited non-distribution services directly.

The AER argues that on balance the \$500,000 materiality threshold is necessary. It would allow DNSPs to provide limited non-distribution services that are incidental to but necessary to support the provision of its distribution services. We do not accept this position. In order for the AER to justify this decision, it needs to provide evidence that the threshold is necessary.

Also, we are concerned the materiality threshold of \$500,000 could potentially have an adverse effect on the market for BTM contestable energy services. As such, we agree the AER should have the right to review this decision if it emerges that the threshold undermines the ring-fencing policy objectives in any way.

Finally, we note that the AER first considered the possibility of applying the materiality threshold that is currently applied to distribution pass through events which is currently set at 1% of annual regulated revenues. We support the AER's decision to reject this value. If it was adopted it would be likely to have materially adverse effects on the markets for BTM contestable energy services.

### **2.3. Establish & maintain separate accounts**

Red and Lumo support the requirement for DNSPs to maintain consolidated and separate accounts for standard control services, alternative control services and other services provided by DNSPs.

Also, we support the requirement for DNSPs to maintain appropriate internal accounting procedures that demonstrate the extent and nature of the transactions between it and related bodies corporate.

These changes are particularly important because the current DNSPs CAMs do not provide for the allocation of costs to non-distribution services. Therefore, if a DNSP provides services to its ring fenced affiliate we would expect that the transactions:

- are reported consistent with the requirements under 3.2.1(a) of the Draft Guideline;
- occur at an arm's length and that the costs of services provided reflect market rates.

### **2.4. Cost allocation**

Red and Lumo support the decision to explicitly restrict DNSPs from allocating distribution services any costs that relate to non-distribution services.

This prohibition is necessary because the cost allocation principles that currently apply to DNSPs in rule 6.15 of the NER, only apply to the attribution and allocation of costs between distribution services (i.e. not between distribution and non-distribution services).

This means that the AER has no power to require a DNSP CAM under the Cost Allocation Guideline to reflect the allocation of costs between distribution and non-distribution services. As a result this could potentially allow a DNSP to undertake work for a ring fenced affiliate without being able to allocate the costs for that work (in the form of non-regulated services).

Such an outcome would be unacceptable and diminish competitive neutrality in the competitive markets for non-distribution services. At the same time, we believe it could artificially inflate the costs of distribution services.

## **3. Non discrimination**

### **3.1. General obligations to not discriminate**

Red and Lumo support the general obligations not to discriminate between its related bodies corporate and competitors of those entities. More specifically, we strongly support the requirement for DNSPs to:

- deal with related body corporate at arms-length;
- deal with competitors of its related body corporate on substantially the same terms and conditions as those for its body corporate;
- avoid providing to its related body corporate information that it has obtained by a competitor of its related body corporate;
- avoid providing advertising or promoting the services provided by its related body corporate.

These provisions will help ensure that a DNSP's related body corporate does not gain an unfair advantage over its competitors in the market for BTM contestable energy services.

### **3.2. Specific obligations for functional separation**

Red and Lumo support functional separation in the following two areas:

- physical separation a DNSPs offices from its service providers or related bodies corporate;
- preventing staff sharing between a DNSP and its related body corporate.

These obligations complement the general obligations to not discriminate between its related bodies corporate and competitors of those entities. Further, in the absence of these provisions there is a risk that of a DNSP related bodies corporate gaining an unfair advantage.

### **3.3. Specific obligations for information access and disclosure**

Red and Lumo support the obligations that apply to DNSPs in relation to information access and disclosure. More specifically, we support the requirement for DNSPs to:

- protect information provided to DNSPs for providing direct control services and ensure it is used only for the purposes that it was provided for;
- share information it acquires in providing direct control services on an equal basis;
- not to disclose information acquired in providing direct control services, including related body corporate, without getting the explicit informed consent of the relevant customer.

These specific obligations complement the general obligations not to discriminate between its related bodies corporate and competitors of those entities. Furthermore, in the absence of these provisions, there is a real risk of a DNSP related bodies corporate gaining an unfair advantage.

## **4. Waivers**

Red and Lumo support the AER's restricted approach to the granting of waivers under the Draft Guideline.

The AER's revised approach to ring fencing means it will only assess waiver applications that apply to the functional separation of either accommodation and or/employees. The AER's decision to restrict waiver applications that apply to legal separation, cost allocation and information protection is strongly supported.

In making a determination in response to a waiver application, the AER has argued it would make any decision based on the potential for cross subsidisation and discrimination. We support this approach.

Given the potential threat to competitive markets from cross subsidisation and discrimination it is important for the AER to set a very high threshold in relation to granting waivers that apply to functional separation.

## **5. Compliance & Enforcement**

Red and Lumo support the rigorous monitoring and reporting regime that applies under the Draft Guideline.

The strong compliance regime implemented by the AER will ensure that the development of BTM contestable energy services is not undermined by cross subsidies or discrimination.

More specifically, we support the following provisions that form part of the compliance regime including:

- placing the onus on DNSPs to demonstrate compliance with the Draft Guideline;
- requiring each DNSP to publicly report annually on:
  - its compliance with respect to each of ring-fencing obligation
  - compliance breaches and remedies
  - an independent third party audit of its compliance
- summary financial accounts for each ring fenced entity indicating the size of any transactions with the DNSP.

## **6. Conclusion**

Red and Lumo thank the AER for the opportunity to respond to its Draft Guideline.

The Draft Guideline represents a positive step forward to ensuring that the market for BTM contestable energy services develops in a competitively neutral manner.

We acknowledge that there are other parts of the regulatory regime for electricity distribution that will require amendment to ensure competitive neutrality in the supply of BTM contestable energy services and that these are beyond the scope of the Draft Guideline.

For further enquiries regarding this submission, please call Con Noutso, Regulatory Manager on 03 9976 5701.

Yours sincerely

A handwritten signature in black ink, appearing to be "Ramy Soussou", with a horizontal line extending to the right.

**Ramy Soussou**

General Manager Regulatory Affairs & Stakeholder Relations

**Red Energy Pty Ltd**

**Lumo Energy Australia Pty Ltd**