

23 September 2016

Mr Chris Pattas
General Manager, Network Investment and Pricing
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3000

By email: Ringfencingguideline2016@aer.gov.au

Dear Chris,

Draft Ring-Fencing Guideline – Electricity Distribution

Simply Energy welcomes the opportunity to respond to the Draft Ring-Fencing Guideline – Electricity Distribution (the Guideline).

Simply Energy is a leading tier 2 energy retailer servicing Victoria, South Australia, New South Wales, Queensland, and the Australian Capital Territory.

Simply Energy considers that the proposed approach, which is based on accounting information provided by distribution businesses, is overly complex and unlikely to effectively safeguard the nascent competitive markets it is intended to protect. A more effective approach would be a simpler model that directly protects these markets, by preventing distribution businesses from providing regulated services to consumers 'behind the meter'.

Additionally, there are aspects of the Guideline that have the potential to undermine the approach proposed by the Australian Energy Regulator (AER), and which therefore need to be addressed. Examples are provided below in relation to separate accounts, obligations to not discriminate, staff sharing, and sharing of information. These issues generally relate to regulated distribution businesses who outsource the provision of regulated services to related parties. To be effective, the Guideline's provisions need to apply to outsourced services. It is unclear whether the current drafting achieves this.

The Guideline is insufficient to address the risks to nascent competitive markets

The AER considers that its powers do not enable it to require that distribution businesses adopt specific legal ownership structures that will safeguard nascent competitive markets ('structural separation'), nor does it consider that it can address risks to these markets by preventing regulated distribution businesses from providing regulated services into these markets.

As a result, the AER has developed a draft Guideline that seeks to manage risks to these markets by requiring distribution businesses to deal transparently with all businesses in these markets, whether related to the distribution business or not, and to report openly and honestly on these dealings. In addition, the distribution businesses must apply a strengthened version of the AER's cost allocation methodology for costs that are shared between the regulated distribution business and its related parties.

The AER's enforcement approach is based on its ability to receive reports (including accounting information) from the regulated distribution businesses that are sufficient for it to determine whether these businesses are impacting these new markets. A range of factors lead us to question whether this approach can effectively address the risk to nascent competitive markets posed by regulated distribution businesses providing services into these markets.

These factors include the following:

- Distribution businesses prepare their own reports.
- Distribution businesses appoint and remunerate the party that audits their reports.
- Audits are based on materiality – they are only expected to find issues that are material to the results they are reporting.
- As a result, audits cannot be expected to find issues that are not material to the distribution business (some of which measure assets and revenues in billions), but which are highly material to the small, nascent competitive markets that these measures are intended to protect.
- Some distribution businesses have long experience in using complex group structures and related party transactions to deliver regulated and non-regulated services. We would like to see evidence that the AER has the resources to fully understand the implications of these complex structures and their potential impact on the competitive markets at risk.
 - There are 13 electricity distribution businesses – five in Victoria, three in New South Wales, two in Queensland and one each in South Australia, Tasmania, and the Australian Capital Territory.
 - We are keen to understand that the AER will be able to deploy sufficient resources to effectively enforce the guideline requirements on 13 businesses.

A simpler model to directly protect the nascent competitive markets

Simply Energy considers that these emerging competitive markets will be better protected by a simple model that directly protects them, rather than a complex model based on successfully monitoring distribution businesses through reports they generate themselves.

As has been proposed before, we consider that an appropriate model is one that prevents distribution businesses from providing regulated services to consumers 'behind the meter'.

This will provide effective protection to allow the growth of the competitive markets for 'behind the meter' products and services, which otherwise are at risk of being overwhelmed by regulated businesses. It is in the long-term interests of consumers that these markets are able to grow in the absence of dominance by monopoly businesses, maximising choice and value.

The current draft guideline

As discussed above, Simply Energy does not consider that the current draft guideline is likely to effectively allow the growth of competitive markets for new consumer energy products and services. However, Simply Energy does not wish to lose this opportunity to comment on details of the guideline as proposed by the AER.

The draft guideline relies on third party auditors providing an opinion on reports generated by distribution businesses. We consider that there would be more confidence in the reports if the AER was to appoint and control the audits. More confidence in the reports would give competitive businesses more confidence that they can participate in these new markets without concern that their investments will be eroded by the impact of regulated monopolies on these markets.

The 'Separate accounts' clause requires distribution businesses to set up its accounting so that the AER has visibility of the transactions between the distribution business and its related parties. This is a critical part of the AER's approach, but it is only a start. Effective oversight of these related party transactions requires the AER to obtain sufficient information to determine if payments to related parties are on an arms-length basis or represent a shift of costs from the related party to the regulated business. This is critical because otherwise regulated revenue can be used to subsidise or insure the related party's activities in the competitive market.

The 'General obligations to not discriminate' require the distribution business to have separate branding for distribution services from its related party that provides non-distribution services. This is important, but Simply Energy does not consider that it is sufficient to prevent distribution business related parties from leveraging the distribution business's brand, with advertising such as "Brand X, DNSP Y's solar partner".

The 'Staff sharing' requirements require separation between distribution business staff providing direct control services and staff providing or marketing a related party's competitive services. Again, this is necessary but not sufficient to achieve the Guideline's objectives. In particular, it does not address the situation where a distribution business has no staff providing direct control services, and all of this work is outsourced to a related party. What prevents the related party outsourced contractor from using the same staff to provide direct control services under its contract with the distribution business and also marketing and providing its own services in a competitive market?

Also, in this scenario is there anything that would prevent the outsourced service provider's staff from favouring their employer's customers in a competitive market over the customers of a competitor, when carrying out services under the contract with the distribution business?

Similarly, it is not clear to us how the 'Sharing of information' clause is workable in the case where customer information is provided to a related party outsourced contractor so that it can deliver direct control services under its contract with the distribution business. It is likely that the distribution business provides customer information to the related party that it is not able for privacy or confidentiality reasons to make available to third parties who compete with the related party in competitive markets. In this example the related party will have access to customer information that is not available to competitors, giving it an inappropriate advantage in the competitive markets it participates in.

If you have any questions about this submission please do not hesitate to contact me on (03) 8807 1171.

Yours sincerely

A handwritten signature in blue ink, appearing to read "James Barton", with a horizontal line underneath.

James Barton
General Manager Regulation