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UNITED ENERGY

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Mr Chris Pattas
General Manager – Network Operations and Development
Australian Energy Regulator
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Email: chris.pattas@aer.gov.au

Dear Chris,

RE: Electricity Ring Fencing Guidelines – Preliminary Positions

United Energy (UE) appreciates the opportunity to provide comments on the AER's Preliminary Position in relation to ring-fencing guidelines. There are a number of aspects that we support in the position paper. These are:

- Providing a level playing field for all parties providing energy services - in other words not seeking to lock out distribution business owners from competing in the competitive market (via a non-regulated business structure);
- Adopting a service based approach rather than an asset based approach to ring-fencing;
- Not allowing DNSP's to use regulated assets in providing competitive energy services; and
- No need to have waivers (or ring-fencing requirements) in place for services purchased for the provision of regulated services

In relation to the role of ring-fencing the paper states that

> *The fundamental purpose of ring-fencing is to assist the development of competitive markets where competition is feasible and to apply incentive based regulation to the monopoly network market sectors where completion in not feasible.*

The AER's primary role is the regulation monopoly network businesses. The market and innovative market participants will develop competitive markets. There is no need to develop ring-fencing guidelines in order to develop competitive markets. The AER's role is to ensure that customers of regulated businesses are not paying or taking the risk of investing in competitive markets. Any competitive investment or competitive activities should be borne by shareholders.

Our view is that all regulated services are classified via the service classification approach. By definition anything not included as a regulated service is non-regulated and therefore these non-regulated services need to be provided by the competitive market. There is no need to develop a list of non-regulated services – they are defined by exclusion from the service classification.

We also note that strong financial governance is already in place to monitor compliance with competitive activities. All business are required to have an AER approved Cost Allocation Method (CAM) in place which clearly requires businesses to allocate costs that are not regulated to a non-regulated category – ensuring that the regulated customers do not pay for these activities. Businesses are required to comply with these guidelines via the annual RIN process which in turn is audited by external auditors.

The paper also provides some examples in relation to the waiver process. The waiver process should be kept to a minimum with the Rules and the proposed guidelines dealing with a majority of cases. A waiver process will not provide sufficient guidance in advance of any ring-fencing issues that arise – the guideline needs to provide the certainty not the waiver process.

If you have any question in relation to this submission please call me on (03) 8846 9860 to discuss further.

Yours sincerely

Andrew Schille
General Manager Regulation and Corporate Affairs

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Attachment – Response to AER questions

1. What aspects of current jurisdictional ring-fencing arrangements have or have not worked well?

The current Victorian guidelines together with the RIN processes, CAMs and the Rules provide sufficient guidance. It seems that this position paper is based on the Queensland arrangements. Whilst there is no specific objection to that UE reminds the AER that the ring-fencing guidelines should be based on the Rules and be compliant with the Rules.

2. Do you consider these objectives in section 2.1 adequately reflect the harm ring-fencing is seeking to avoid and the benefits of an even playing field?

UE agrees with the AER objectives listed in section 2.1 of the Preliminary Position paper.

3. Do you agree with the service classification approach to ring-fencing which is discussed in section 3.3? Is there a better alternative?

In our view the current service classification process effectively establishes what services are delivered by the DNSP (the ring-fenced entity). By definition all other services are non-regulated and provided by the competitive market. There is no need to provide a list of competitive services. The AER's role is to regulate monopoly markets not establish a list of services that can be provided in a competitive market. The market will establish its own list as they develop.

This is clearly also consistent with the limits on the AER's role in developing the guidelines. The AER refers to a "literal" reading of clause 6.17.2 linking ring-fencing to classification. However it's not so much a literal reading, but a plain and simple reading of clause 6.17.2(a) that establishes that which is ring-fenced is the provision of direct control services, not contestable services (or as the paragraph refers to them, "other services").

4. Does the proposed approach to ring-fencing adequately deal with the prospects for development of the contestable market for DER?

In all cases UE would consider all options listed in the example. In all cases UE (as the DNSP) would choose the least cost option. Any of the three options could be viable depending on the circumstances. In the case where option 1 is considered there may be consideration in the future that if at some stage the DER was being used in the competitive market the DNSP would be required to sell the asset and purchase back the relevant regulated service. The sale could be to a related or non-related entity. The sale consideration should depend entirely on what is best option for the regulated business.

5. Are the other ring-fencing obligations we should impose on NSPs that provide services into contestable markets?

UE considers that two of the proposed obligations are potentially not workable. These are:

- Sharing of staff; and
- Location of physical premises

UE and Multinet Gas customers receive a significant benefit via the sharing of resources and locations. Sharing of services such as corporate services, IT services etc. go to reducing the cost base of both UE and Multinet Gas. This is one of the reasons both of these companies are amongst the most efficient in the country for the provision of network services. If further efficiencies can be found by the sharing of these services with a competitive related party then this should be encouraged. This will further reduce

the cost base of the regulated businesses and be passed through to customers in the form of lower tariffs.

Non-regulated market participants aim for as much sharing as possible in order to reduce costs and stay competitive. Reaching into these companies to reduce sharing at the expense of increasing costs for consumers cannot be consistent with the NEO. Allowing regulated business to further reduce costs is consistent with the NEO.

The AER refers to the QCA's guidelines. UE refers the AER to the Victorian ESC guidelines and the definition of distribution staff (subject to ring-fencing) as

distribution staff in respect of a distributor, means staff of the distributor directly involved in marketing or providing the distributor's distribution goods and services (whether or not they are also involved in other functions) but does not include staff involved only in:

(a) strategic decision making, including the executive officer or officers to whom distribution staff report either directly or indirectly; or

(b) the distributor's administrative, accounting, finance, human resources or information technology support functions.

Moreover, the Victorian guideline requires much less restrictive arrangements for location sharing:

A distributor must ensure that any organisational unit marketing or providing the distributor's distribution goods and services and any organisational unit within a retail business:

(a) operate independently; and

(b) have separate work areas with access controls that prevent staff of either organisational unit from entering into the work area of the other organisational unit.

At section 4.4 of its decision in October 2004, the ESC discusses its rationale for these guidelines. UE submits that the NEO leads to the Victorian, not the Queensland, arrangements.

6. What costs would be incurred in meeting these obligations?

This would depend on the actions of the AER. For example if the AER could utilise existing arrangements in place such as Annual RINS there would be no additional costs in relation to separate accounts. However if the AER sought additional reporting and/or legal separation than these would come at a cost of regulated customers (given that ring-fencing is in relation to the regulated business). Physical separation and reduced cost sharing all adds to total costs incurred by consumers for no additional utility.

7. Should asset sharing be restricted between regulated services and contestable service provision?

Sharing of existing assets should be encouraged. Denying this opportunity is denying consumers to potential tariff reductions. For example most DNSPs share poles with telecommunication companies and share that benefit with regulated customers.

In UE's view it is a heavy burden for the AER to establish that a ban on asset sharing promotes the NEO.

8. Do the factors set out above (section 5 of the position paper) reflect the issues we should consider in deciding whether to grant a ring-fencing waiver?

It is important that any new regulation does not stifle innovation and participation in competitive markets. This includes the ability of a DNSP related party entering into competitive markets.

It is equally important that the concept of waivers is not used as a tool for prescriptive regulation on the basis that a waiver can, in certain circumstances, undo the harm of that regulation. Any prescriptive regulation must be justified by reference to the NEO on its merits without having waivers as an excuse for that regulation.

In addition, the broader the scope for waiver to more likely it is the AER will have failed to exercise the discretion it is required to exercise under Rules to make the guideline, instead deferring the exercise of the discretion.

9. In which circumstances should the customers of ring-fenced services and not customers of the DNSP's services in general pay the additional costs of complying with ring-fencing obligations?

The ring-fenced entity is the regulated entity. This is a clear position of the Rules and we refer again to clause 6.17.2(a) which separates the provision of direct control services; the AER's position paper tends to read this clause the other way around – the Rules are in place for the regulated business not the unregulated business and require the regulated business to comply with the ring-fencing guidelines. Therefore the costs of compliance should be with regulated business. Ring-fencing is a regulatory obligation or requirement within the meaning of section 2D of the NEL, the costs of which are recoverable under the Rules by the regulated business.

10. How else could the AER minimise the administrative cost of ring-fencing while maintaining the integrity of its approach?

The AER should utilise other arrangements already in place to minimise the cost of ring fencing. For example the information provided by the DNSPs in response to RINs can be used by the AER to monitor compliance.

11. Is it reasonable for the AER to consider these transitional arrangements to the new ring-fencing guideline?

Broadly we would agree with the AER of the proposed transitional arrangements – in particular the AER's preference to maintain current jurisdictional arrangements - this is contemplated in 11.4.5 of the Rules.

We are less supportive of the 12 months to be able to comply. Contractual arrangements may be in place that require for a longer period of transition. The AER has been contemplating ring-fencing guidelines since at least 2011 (see http://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/ring-fencing-guidelines-review-distribution-2011-2012-suspended). To impose a blanket 12 month compliance provision seems unjustified given the time elapsed and uncertainty since at least 2011.

12. How can we ensure ring-fencing compliance is robust and effective without imposing excessive costs that may ultimately be borne by consumers?

United Energy provide significant amounts of information to the AER as requested. For example we already provide on an annual basis the Annual, Category Analysis and Economic Benchmarking RINs. We also provide a price review RIN every 5 years. These can all be used as compliance tools for ring-fencing.

United Energy has CAM in place (approved by the AER) that also is a compliance tool for ring-fencing. The CAM (together with the Rules) does not allow UE to allocate costs to the regulated business that are for the provision of competitive services - these are allocated to other.

The AER also has a significant amount of benchmarking data that can be used for compliance of ring fencing. Where regulated business are demonstrated to be efficient this can be used as a strong guide that non-regulated costs are not allocated to the regulated business.