

## ELECTRICITY DISTRIBUTION RING-FENCING ANNUAL REPORT

2018-19



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## 1. Introduction

This Annual Report provides information about the operation of the ring-fencing framework under our [Electricity Distribution Ring-fencing Guideline](#) (the Guideline) in 2018-19.<sup>1</sup> The report provides our assessment of distributors' overall compliance with the Guideline and outlines our priorities for the coming year. It also highlights drivers of ongoing reform to the regulatory framework for ring-fencing. The issues outlined in this and the previous year's ring-fencing annual report are informing our current review of the Guideline.<sup>2</sup>

Over the period covered by this report we have observed general improvement in distributors' compliance with the Guideline and greater transparency in distributors' compliance reporting. This compares favourably to the period covered by last year's report, when distributors reported a number of significant breaches of the Guideline.<sup>3</sup> While noting this general improvement, we continue to monitor compliance particularly in regard to the allocation of shared costs, staff sharing, and the sharing of information.

Through the year, complaints from stakeholders have resulted in a number of ring-fencing compliance investigations, some of which resulted in distributors reporting breaches of the

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<sup>1</sup> Note this Annual Report covers NSW, Queensland, ACT, Tasmanian and South Australian distributor compliance as reported for the 2018-19 financial year. This report also covers Victorian distributor compliance as reported for the 2018 calendar year. Due to differences in the timing of distributors' regulatory years, Victorian distributor compliance reporting aligns with the calendar year, while other distributors' compliance reporting aligns with the financial year.

<sup>2</sup> Further information on the Guideline review is available at: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/electricity-ring-fencing-guideline-review-august-2019>.

<sup>3</sup> AER, *Annual compliance report on the electricity distribution ring-fencing guideline 2017-18*, March 2019.

Guideline to the AER and taking action to remediate breaches. We are grateful to all stakeholders who have contributed to our compliance and enforcement activities.

As of 6 February 2020, civil penalties can be imposed for breaches of the Guideline. Amongst other things, this means we can issue infringement notices where we have reason to believe a breach of the Guideline has occurred. This change was made to recognise the importance of ring-fencing in protecting the competitiveness of markets for contestable electricity services.

We encourage stakeholders with complaints or questions to contact us at [ringfencing@aer.gov.au](mailto:ringfencing@aer.gov.au).

## 1.1 Our Compliance Approach

Our compliance approach is grounded in the objectives of the national energy laws: promoting the interests of consumers, enabling effective market competition where competition is feasible, and facilitating efficient operation of regulated networks where regulation is necessary. We actively monitor the market and assist businesses to understand their obligations under the Guideline in order to foster a culture of compliance.

The AER monitors and enforces compliance with the Guideline in several ways:

- **Distributor self-reporting.** The Guideline places clear obligations on distributors to proactively report, correct and remediate breaches of the Guideline throughout the year. This includes reporting material breaches within five days of becoming aware of the breach.<sup>4</sup> Distributors are also required to implement appropriate systems, policies and processes to comply with the Guideline.<sup>5</sup> Distributors must report on this annually.<sup>6</sup> Distributors' annual reports and independent assessor reports are available on our [website](#).
- **Independent assessments of compliance.** Distributors must engage an independent third party to assess their compliance annually.<sup>7</sup> Detailed, long-form assessor reports have proven to be effective in identifying breaches of the Guideline, highlighting opportunities for distributors to strengthen their compliance and instilling confidence in the ring-fencing framework.
- **Complaints and intelligence from members of the public.** We receive and action reports about the conduct of energy related businesses from diverse stakeholders, including consumers, businesses, industry bodies, government agencies and consumer groups. Complaints and intelligence from stakeholders have triggered investigations identifying significant compliance issues.
- **Audits, market surveillance, targeted compliance reviews and information requests.** We deploy many other less visible monitoring tools to identify and prevent failures in compliance before they become systemic issues, prompting distributors to report and remediate breaches.

A breach can come to our attention either through pro-active self-reporting by a distributor, complaints from the public, or an AER investigation. We assess the materiality of breaches on a case-by-case basis, and respond to breaches according to the enforcement factors

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<sup>4</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 6.3.

<sup>5</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 6.1.

<sup>6</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 6.2.1(a-b).

<sup>7</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 6.2.1(c).

outlined in our [Compliance and Enforcement Policy](#) and in the [Electricity Distribution Ring-Fencing Guideline – Compliance Reporting Best Practice Manual](#).<sup>8</sup> This assessment determines our enforcement response, with the aim of ending the unlawful conduct and fostering future compliance within the industry.<sup>9</sup>

Further background on the development of the Guideline can be found in [last year's annual report](#).<sup>10</sup> The National Electricity Rules (NER) required all distributors in the National Electricity Market (NEM) to comply fully with the Guideline from 1 January 2018.<sup>11</sup>

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<sup>8</sup> AER, *Compliance and Enforcement Policy*, July 2019, p 8; AER, *AER Electricity Distribution Ring-Fencing Guideline Compliance Reporting Best Practice Manual Version 2*, July 2019, p 7.

<sup>9</sup> AER, *Compliance and Enforcement Policy*, July 2019, p 8.

<sup>10</sup> See Appendix A: AER, *Annual compliance report on the electricity distribution ring-fencing guideline 2017-18*, March 2019, pp 18-23.

<sup>11</sup> NER, cl. 6.17.1. Note certain clauses of the Guideline applied to the Northern Territory from 1 July 2019. Therefore, the Northern Territory is not covered in this report.



## 2. A Snapshot of 2018-19

We consider that overall compliance with the Guideline has improved over time. In the ring-fencing compliance period covered by this report (2018-19), independent assessments of compliance identified fewer compliance issues and breaches compared to last year. However, we continue to observe a number of compliance issues, particularly in relation to sharing of staff between a distributor and its affiliates, sharing of confidential information, and cost allocation.

### 2.1 Supporting competition in a changing energy market

Ring-fencing aims to ensure that customers experience the benefits of fair competition by requiring clearer separation between regulated services (provided by distributors on a monopoly basis) and contestable energy services. With the ring-fencing framework having been in place for two years, we are starting to observe some of the positive effects of ring-fencing in promoting increased choice for customers and more competitive outcomes in markets for energy services. The two case studies below illustrate how ring-fencing supports consumer outcomes.

#### ***Case study 1: Impact on retail competition in the ACT***

While retail competition commenced in the ACT in 2010, at the end of 2017 only five electricity retailers were offering serving residential customers in the ACT.<sup>12</sup> With the commencement of the Guideline on 1 January 2018, ActewAGL separated its retail and distribution businesses into separate entities. Regulated distribution activities were rebranded as Evoenergy. Since then, four new retailers have commenced offering electricity retail services to ACT residential customers.<sup>13</sup> Over the period 31 December 2017 to 31 December 2019, the percentage of existing customers who switched retailers in the ACT increased from 1.7 percent to 2.7 percent and many new customers arriving in the ACT have

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<sup>12</sup> AER, *Retail market performance update for quarter 1 2018-19 – Q2 retail performance data*, March 2019.

<sup>13</sup> AER, *Retail performance update for quarter 2 2019-20 – schedule 2*, March 2020.

opted to obtain electricity supply from other retailers. While retailers other than ActewAGL accounted for 10.3 percent of the share of the residential market at the end of 2017, as of 31 December 2019 that share had risen to almost 20 percent.<sup>14</sup> We consider that ring-fencing has supported greater retail choice for customers in the ACT.

### **Case study 2: Promoting fairer competition for contestable metering**

In 2018 stakeholders providing contestable metering services alerted us to issues in accessing meter keys. In discussions with Energex and Ergon Energy, we highlighted the risk that Energex and Ergon Energy's affiliates (Metering Dynamics and Yurika) may be advantaged in situations where staff shared between the distributor and the affiliate can access meter keys while their competitors cannot. In late 2019 Energex and Ergon Energy made meter keys accessible to all metering providers and their field crews after working through a complex set of consumer protection issues. This enables competitors of Metering Dynamics and Yurika to provide more convenient and timely metering services to customers.

## **2.2 Staff sharing**

The Guideline prohibits a distributor from sharing staff with an affiliate providing electricity services in situations where those staff have:

- access to information about the network and its customers ('electricity information'), and
- opportunity to use that information in a way that would provide a discriminatory advantage to the distributor's affiliate.<sup>15</sup>

While we have observed improvements to staff separation arrangements by several distributors, staff secondments and sharing of procurement staff remain an area of focus for our compliance monitoring.

We note that a number of distributors have taken a more rigorous approach to staff secondments between distributors and their affiliates in 2018-19, after we highlighted staff secondments as an area of ring-fencing compliance risk in last year's report. For example, as of July 2019 Evoenergy has ceased temporary staff secondments to its affiliates and instead uses permanent transfers where needed. This includes a more stringent process for office and information/IT system access restrictions.<sup>16</sup> Subsequent to lodging its compliance reports, Endeavour Energy informed us it has a minimum term of six months for any secondments between the distributor and its affiliate (Ausconnex). In our 2017-18 annual report, we highlighted how 'short term' staff secondments can lead to free movement of staff between the distributor and the affiliate, effectively circumventing staff separation requirements in the Guideline.

We have also observed improvements in the way distributors are approaching sharing of procurement staff between the distributor and the affiliate. As distributors increasingly engage providers of demand response, distributed energy resources and stand-alone power systems to provide alternatives to traditional network investment, the importance of ring-fencing in supporting fair competition in these emerging industries will increase. Since we raised this issue in our 2017-18 annual report, a number of distributors have adopted a stronger approach to ensuring non-discrimination and appropriate staff separation in their

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<sup>14</sup> AER, *Retail market performance update for quarter 2 2018-19 – Q2 retail performance data*, March 2019; AER, *Retail performance update for quarter 2 2019-20 – schedule 2*, March 2020.

<sup>15</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 4.2.2(b)

<sup>16</sup> Deloitte, *Evoenergy Ring-fencing Compliance Report for the Period 1 July 2018 to 30 June 2019*, p 15 and 34.

tender processes.<sup>17</sup> In particular, Evoenergy has implemented an approach of having dedicated procurement staff that work only for the distributor on the provision of electricity services. Evoenergy has also implemented a more transparent procurement process and has accepted Deloitte's recommendations to further strengthen non-discrimination in its procurement processes.<sup>18</sup>

Ausgrid and SA Power Network's (SAPN's) independent assessors noted these distributors continued to share procurement staff in 2018-19.<sup>19</sup> Further information provided by Ausgrid to the AER following Deloitte's 2018-19 independent assessment confirmed that Ausgrid's affiliate, PLUS ES, has a separate team that performs procurement activities for any contestable electricity services. Further information provided by SAPN to the AER confirmed that SAPN has processes in place to restrict procurement staff information and office access on a temporary basis, where those procurement staff are assigned to provide services to its affiliate, Enerven. On this basis we consider that Ausgrid and SAPN now have adequate separation of procurement staff in place to comply with the Guideline.

More broadly, we consider that more clearly defined and objective requirements for staff sharing would support the transparency and administrative efficiency of the Guideline. This is being addressed in our update to the Guideline.

### **2.3 Protecting confidential electricity information**

The Guideline restricts distributors from sharing confidential electricity information with their affiliates.<sup>20</sup> Independent assessor reports and distributor breach reporting for the 2018-19 period suggests some distributors have not adequately protected confidential electricity information.

#### ***SAPN IT access by Enerven staff***

SAPN's 2018-19 independent assessment found that staff of SAPN's affiliate (Enerven) have access to a number of IT applications that contain confidential electricity information.<sup>21</sup> Notwithstanding a number of soft controls that SAPN has put in place around these IT applications, Deloitte found that there is a risk that Enerven staff continue to have access to 'SAP' IT systems containing confidential information, which could provide an advantage to Enerven. Deloitte recommended SAPN implement formal access restrictions by establishing separate company codes for SAPN and Enerven in its accounts system SAP.<sup>22</sup>

This follows significant issues with SAPN's compliance with the Guideline in 2017-18 when SAPN's independent assessor found that SAPN had applied an incorrect definition of 'confidential information' when it established information access control systems ahead of the Guideline compliance deadline.<sup>23</sup> SAPN has stated that it will not be in a position to implement their independent assessor's recommendations until it knows the outcome of a proposal for additional regulated revenue to cover the cost of SAP IT upgrades under the AER's 2020-25 Revenue Determination.<sup>24</sup>

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<sup>17</sup> AER, *Annual compliance report on the electricity distribution ring-fencing guideline 2017-18*, March 2019, p 10.

<sup>18</sup> Deloitte, *Evoenergy Ring-fencing Compliance Report for the period 1 July 2018 to 30 June 2019*, 30 October 2019, p 34.

<sup>19</sup> Deloitte, *Ausgrid ring-fencing guideline compliance report for the period 1 July 2018 to 30 June 2019*, 30 October 2019, p 3; Deloitte, *SA Power Networks ring-fencing guideline compliance report*, 30 June 2019, p 14.

<sup>20</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 4.3.

<sup>21</sup> Deloitte, *SA Power Networks Ring-fencing Guideline Compliance Report*, 30 June 2019, p 7.

<sup>22</sup> Deloitte, *SA Power Networks Ring-fencing Guideline Compliance Report*, 30 June 2019, p 7.

<sup>23</sup> AER, *Annual compliance report on the electricity distribution ring-fencing guideline 2017-18*, March 2019, p 8; Deloitte, *SA Power Networks Ring-fencing Compliance Report*, 30 October 2018, p 15.

<sup>24</sup> Deloitte, *SA Power Networks Ring-fencing Guideline Compliance Report*, 30 June 2019, p 7.



We do not agree or accept that compliance with existing regulatory requirements should be contingent on the outcome of an AER revenue determination. In the absence of hard information access controls recommended by the independent assessor, we will be closely monitoring arrangements put in place by SAPN to ensure Everven staff do not access or use confidential electricity information. We are also considering this issue as part of our review of the Guideline.

### **Lapses in compliance systems and processes**

In 2018-19 lapses in several distributors' compliance systems and processes resulted in staff of affiliated businesses sometimes having the ability to access confidential electricity information. We sought additional details from the distributors and are satisfied these lapses did not result in harm to competitors of distributors' affiliates or customers. Although retaining access, the staff of the affiliate had for the most part accessed the distributors' information systems. We nevertheless consider these lapses indicate that protection of confidential electricity information is an area where distributors need to strengthen their systems and processes.

In particular, a number of distributors reported that staff seconded from the distributor to the affiliate on a temporary basis retained access to confidential electricity information. For example:

- SAPN's independent assessor (Deloitte) found that two staff seconded to Enerven retained access to IT applications containing commercially sensitive electricity information ('confidential information').<sup>25</sup> SAPN has committed to implementing Deloitte's recommendations to remedy weaknesses in the secondment process.
- CitiPower/Powercor's independent assessor also found that over the 2018 calendar year, staff of the affiliate (Beon) had access to IT systems containing confidential information.<sup>26</sup> A subsequent investigation by CitiPower/Powercor did not find any harms to competitors of the affiliate or customers resulting from this breach, and confirmed that most affected staff were not aware that they had access to IT systems containing confidential information.
- Endeavour Energy's independent assessor (PwC) found that two staff previously seconded to Ausconnex retained access to Ausconnex drives when they returned to Endeavour Energy.<sup>27</sup> PwC performed detailed audits of staff access logs and found that these staff had not viewed restricted confidential information, concluding that no harm resulted from these breaches.<sup>28</sup>

## **2.4 Enhancing access to information about the network**

We have received anecdotal reports that some distributors are restricting access to various types of electricity information about the network for all third parties. We are concerned that in some cases distributors may be misinterpreting their ring-fencing obligations to mean that confidential electricity information cannot be shared with any third party. Ring-fencing aims

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<sup>25</sup> Deloitte, *SA Power Networks Ring-fencing Guideline Compliance Report*, 30 June 2019, p 5.

<sup>26</sup> Deloitte, *CitiPower and Powercor Ring-fencing Guideline Compliance Report*, 30 April 2019, p 6.

<sup>27</sup> PwC, Independent assurance report to the directors of Endeavour Energy and the Australian Energy Regulator, 30 October 2019, pp 6-7.

<sup>28</sup> PwC, Independent assurance report to the directors of Endeavour Energy and the Australian Energy Regulator, 30 October 2019, p 7.

to prevent asymmetric sharing of confidential electricity information between a distributor and an affiliate. It does not aim to restrict access to network information more broadly. In fact, one strategy to comply with the Guideline is for distributors to make more information about their network available, which reduces the risk that sharing electricity information may discriminate in favour of an affiliate.

### ***How distributors can support information access under the Guideline***

Distributors have a range of options to comply with their obligations under clause 4.3 of the Guideline. They can:

- Protect confidential electricity information and not disclose it to anyone, including a related electricity service provider, except in particular circumstances specified in the Guideline.<sup>29</sup>
- Provide confidential electricity information to an affiliate, either directly or via a third party, and ensure competitors of the affiliate can access that information on an equal basis via the information register process.<sup>30</sup>

Make confidential electricity information publicly available, in which case the information is no longer confidential and does not need to be protected.

As part of the current review of the Guideline, we will provide further guidance on distributors' obligations with respect to sharing and protecting sensitive electricity information.

## **2.5 Cost allocation**

The Guideline requires a distributor to allocate costs shared by the distributor and the affiliate in accordance with a Cost Allocation Method approved by the AER.<sup>31</sup>

In late 2019 an AER investigation found that Endeavour Energy had not been appropriately allocating the cost of materials it shared with Ausconnex. Ausconnex was able to use these resources (mostly comprising small capital cost items like tools and trailers) at no cost to Ausconnex, resulting in a cross-subsidy. Endeavour Energy has committed to establishing new arrangements to allocate the cost of using small capital cost items to Endeavour Energy. It has invoiced Ausconnex for use of these items back to 1 January 2018 to address the cross-subsidy. At our request, Endeavour Energy commissioned an external audit to evidence repayment of these cross-subsidies and demonstrate that systems have been implemented to prevent similar breaches in future.

## **2.6 Follow up to breaches in the previous year**

Our first Ring-fencing Annual Report highlighted a number of significant breaches by Evoenergy and Ausgrid. In 2018-19, Ausgrid and Evoenergy worked to remediate these breaches and put in place systems and processes to strengthen future compliance. Having addressed the breaches, Evoenergy commissioned EY to audit and confirm its compliance with the Guideline. An audit by Deloitte in regard to compliance in 2018-19 also confirmed controls to prevent discrimination in favour of an affiliate and protect confidential electricity information, two areas where Evoenergy had not complied with the Guideline in the previous

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<sup>29</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 4.3.3.

<sup>30</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 4.3.4 and 4.3.5.

<sup>31</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 3.2.2.

year.<sup>32</sup> On this basis, we are satisfied Evoenergy has now addressed the non-compliance issues identified in the previous year.

Ausgrid commissioned two compliance audits by KPMG that confirmed corrective actions had been taken to address breaches noted in last years' annual report. The breaches were largely concerned with inappropriate staff sharing and sharing of confidential electricity information. The audits also examined any related weaknesses in Ausgrid's systems and processes which might contribute to future similar breaches.<sup>33</sup> An independent assessment of Ausgrid's overall compliance with the Guideline for 2018-19 confirmed there are no ongoing compliance issues relating to these breaches.<sup>34</sup>

## 2.7 Independent assessments

Distributors are required to undertake an annual assessment of compliance with the Guideline by a suitably qualified independent authority.<sup>35</sup>

Independent assessments have proven to be effective in identifying and prompting distributor reports of breaches and are vital for the transparency of the ring-fencing framework. In 2018-19 we have observed a general improvement in independent assessor reports, following some variability in the quality and transparency of in the first round of independent assessment reporting.<sup>36</sup>

However, some independent assessors have not adequately demonstrated how they considered previous breaches of the Guideline in their assessments. Independent assessors should use past breaches to inform their assessment methodology and findings, and provide detailed information about this in their public assessment reports. For example, we note Deloitte's report for Ausgrid did not detail how Deloitte tested compliance systems and processes that contributed to significant Guideline breaches reported to us by Ausgrid (described above). Following lodgement of the report, Deloitte clarified to us that it had in fact examined areas relevant to past breaches, including Ausgrid's staff secondment process, office separation arrangements, cost allocation of shared staff, and protection of confidential information at the depot level. Describing this process more substantively in Deloitte's report would have reassured the AER and industry stakeholders that Ausgrid has addressed the root causes of past breaches of the Guideline. Ausgrid has committed to work closely with us on the terms of reference for next year's independent assessment.

Opportunities remain to strengthen the robustness and transparency of the ring-fencing framework further by:

- Ensuring independent assessors **rigorously test how distributors allocate shared costs** between the distributor and the affiliate. In particular, the Guideline requirements go beyond the requirements of Regulatory Information Notice (RIN) reporting, by requiring appropriate allocation of costs between distribution and non-distribution services.<sup>37</sup> This includes, where possible, identifying shared costs that may not be covered in a distributor's existing internal accounting procedures. For

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<sup>32</sup> Deloitte, *Evoenergy ring-fencing guideline compliance report for the period 1 July 2018 to 30 June 2019*, 30 October 2019, p.13, pp. 20-21.

<sup>33</sup> Ausgrid, *Ausgrid 2018/19 Ring-fencing Compliance Report*, 31 October 2019, p 10.

<sup>34</sup> Deloitte, *Ausgrid ring-fencing guideline compliance report for the period 1 July 2018 to 30 June 2019*, 30 October 2019.

<sup>35</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 6.2.1(c).

<sup>36</sup> AER, *Annual compliance report on the electricity distribution ring-fencing guideline 2017-18*, March 2019, p 8.

<sup>37</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 3.2.2(b).

example, we note lapses in allocation of shared costs between Endeavour Energy and Ausconnex (described above) were not detected by the independent assessor.

- Ensuring independent assessors **revisit lapses or weaknesses in compliance systems that contributed to any past breaches** of the Guideline and report in detail on the outcomes of that assessment.
- Ensuring independent assessors **provide sufficient detail on their testing methodologies and the outcomes of that testing**, particularly in areas where a business may be at risk of future breaches.
- **Rotating independent assessors** periodically. Distributors should commission different independent assessors over time, to ensure they maintain their independence.

In our *Compliance Reporting Best Practice Manual* we require detailed, long-form independent assessor reports.<sup>38</sup> In particular, we consider that Deloitte's report for SAPN, PWC's report for Endeavour Energy, Deloitte's report for AusNet Services, and Deloitte's report for CitiPower/Powercor provided an appropriate level of detail regarding how assessments and tests were performed and what the outcomes of this testing was for each Guideline obligation.<sup>39</sup>

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<sup>38</sup> AER, *Electricity distribution ring-fencing guideline – Compliance reporting best practice manual – Version 2*, July 2019, p 16.

<sup>39</sup> Our 2017-18 Annual Report also highlighted high quality independent assessments reports from that year: AER, *Annual compliance report on the electricity distribution ring-fencing guideline 2017-18*, March 2019, p 8.



### 3. Priorities for 2020

#### 3.1 Support innovation in the energy market

Ring-fencing supports innovation by creating a fairer playing field for competition in new and emerging markets for energy services. The AER works collaboratively with distributors to identify areas where further guidance on undertaking innovative projects may be needed.

We have provided informal guidance to distributors in relation to innovative trials and ring-fencing compliance to determine whether a waiver may be necessary. Many of the innovative service trials undertaken in 2018-19 proceeded without a waiver, as the distributors, in consultation with the AER, chose to partner with an affiliate or another contestable service provider or to limit the scope of their trial.<sup>40</sup> Where a distributor partners with an affiliate to undertake a trial or innovative solution, Guideline requirements mitigate risk of information shared through a trial providing a discriminatory advantage to the affiliate.<sup>41</sup>

In December 2019 we published an [Explanatory Note](#) on the interaction between ring-fencing obligations and the AEMC's distributor-led stand-alone power systems draft rules.<sup>42</sup> We published this Note to support informed stakeholder comments on the ring-fencing implications of the AEMC's rule change process.

The AER recently supported the AEMC's proposal to waive parts of the energy rules to support innovative trials, and develop a sandbox waiver mechanism through a guideline. In preparing our submissions to the AEMC we drew lessons from the ring-fencing waiver process. We envision dynamic interactions between ring-fencing and sandboxing waivers in the future.

#### 3.2 The Distribution Guideline review

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<sup>40</sup> AER, *Annual compliance report on the electricity distribution ring-fencing guideline 2017-18*, March 2019, p 17.

<sup>41</sup> AER, *Ring-fencing Guideline Electricity Distribution – Version 2*, October 2017, cl 4.3.4.

<sup>42</sup> AER, *Explanatory Note - Ring-fencing interaction with distributor-led stand-alone power systems*, December 2019.

An important part of our compliance strategy is active adaptation of the Guideline to ensure that distributor obligations are clear and fit-for-purpose. While distributors and their affiliates can play an important role in the provision of electricity services, their involvement in these markets could impact development of competition and consumer choice. The Guideline seeks to strike a balance between competing objectives. An important part of the ring-fencing framework is ensuring the Guideline remains effective.

The annual reporting process has revealed that some obligations in the Guideline are open to misinterpretation.<sup>43</sup> We have also received stakeholder feedback that some distributors may be taking approaches to cost allocation, staff sharing and information disclosure that increase the risk of breaches.<sup>44</sup> Our review of the Guideline will consider how we can improve the Guideline's effectiveness while ensuring resulting compliance costs are proportionate to meeting the objectives of ring-fencing.

In light of these observations, in 2020 we intend to review and amend the Guideline to resolve ambiguities and simplify ring-fencing requirements through a consultative process. We are currently considering more specific provisions governing staff sharing, treatment of confidential information, and breach reporting, amongst other things. Our response to the challenges to the energy sector arising from the COVID-19 pandemic means this work will be conducted over a longer timeframe, to allow businesses and other stakeholders to focus on more immediate issues.

### **3.3 Civil penalties**

On 6 February 2020 the National Electricity (South Australia) Regulations were amended to designate clause 6.17.1 of the NER as a civil penalty provision, allowing the AER to issue Infringement Notices in response to reported breaches.<sup>45</sup> The AER's current enforcement options now include the ability to serve infringement notices and seek civil penalties.

The AER advocated to attach civil penalties to the ring-fencing framework in response to breaches of the Guideline identified in last year's Annual Ring-fencing Report.<sup>46</sup> Where enforcement action is required in response to a breach, we select the most appropriate enforcement tool by assessing the materiality of the reported breach against the enforcement factors in the AER Compliance and Enforcement Policy.<sup>47</sup> We will continue to apply these enforcement factors when determining what enforcement response, if any, is warranted for breaches of the Guideline that occur (or have occurred) after the designation of clause 6.17.1 as a civil penalty provision.

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<sup>43</sup> AER, *Electricity Distribution Ring-Fencing Guideline update – summary workshop notes*, August 2019, pp 1-4.

<sup>44</sup> AER Distribution Ring-fencing Guideline Update Stakeholder Workshop, *Meeting between AER, NECA and ASPs*, October 2019, pp 1-2; AER Distribution Ring-fencing Guideline Update Stakeholder Forum, *NECA -Electricity Distribution Ring-fencing Guideline review submission*, October 2019, p 3.

<sup>45</sup> South Australian Government, *South Australian Government Gazette No. 12*, 6 February 2020, p 213.

<sup>46</sup> AER, *Annual compliance report on the electricity distribution ring-fencing guideline 2017-18*, March 2019, p 2.

<sup>47</sup> AER, *AER Compliance and Enforcement Policy*, July 2019, p 8.

## 4. Appendix A - Glossary

ACRONYM	NAME
CAM	Cost Allocation Method
Distributor	Distribution Network Service Provider
NEM	National Electricity Market
NER	National Electricity Rules
The Guideline	Electricity Distribution Ring-fencing Guideline

## 5. Appendix B - Distributor's related electricity service providers

Distributor	Related Electricity Service Providers
Ausgrid	Plus ES
Ausnet Services	Mondo
CitiPower/Powercor	Beon
Endeavour Energy	Ausconnex
Energex and Ergon Energy	Ergon Energy Retail Metering Dynamics Yurika
Evoenergy	Commercial business unit ActewAGL
Jemena	Ovida
SA Power Networks	Enerven
United Energy	Beon

## 6. Appendix C – Waivers in 2018-19

From July 2018 to March 2020 we granted two new waivers, both of which were adjustments to existing waivers. We granted one new waiver to Essential Energy, which expanded a waiver we granted in 2017, to allow the distributor to provide accredited service provider training in three additional regional towns in NSW.<sup>48</sup> We also granted one new waiver to SA Power Networks to account for a small number of contracts to provide non-distribution services that SA Power Networks signed prior to the introduction of the AER's Guideline.<sup>49</sup> Over 2018-19 five waivers expired. As of March 2020 there are 22 active ring-fencing waivers. Further details on these waivers can be found on the AER website.<sup>50</sup>

<sup>48</sup> AER, *Ring-fencing waivers – Essential Energy training waiver update – waiver notice*, 15 August 2019,

<https://www.aer.gov.au/networks-pipelines/ring-fencing/ring-fencing-waivers/essential-energy-ring-fencing-training-waiver/>;

<sup>49</sup> AER, *Ring-fencing waiver notice – SA Power Networks*, 28 September 2018, <https://www.aer.gov.au/networks-pipelines/ring-fencing/ring-fencing-waivers/sa-power-networks-ring-fencing-waiver-september-2018>.

<sup>50</sup> <https://www.aer.gov.au/networks-pipelines/ring-fencing/ring-fencing-waivers>