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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

Dear Mr Pattas,

RE: AER DRAFT RING-FENCING GUIDELINE CONSULTATION PROCESS

Thank you for the opportunity to comment on the AER's draft Ring-Fencing Guideline (Guideline). This letter outlines ATCO Australia's (ATCO Australia) feedback on the draft Guideline, and recommends ongoing dialogue with the AER to ensure the final Guideline fully considers the impact on businesses operating in both the electricity *and* gas sectors.

ATCO Australia and companies within the ATCO Australia group operate within the electricity sector through the ownership and operation of gas fired power stations in Karratha (wholly owned) and Adelaide (co-owned).

ATCO Australia through its wholly owned group subsidiary ATCO Gas Australia Pty Ltd also operates within the gas sector through the ownership and operation of the vast majority of Western Australia's gas reticulation network serving approximately 725,000 end users via the Mid West and South West Gas Distribution System (regulated by the Economic Regulation Authority of Western Australia (ERA)) covering the Geraldton, Bunbury, Busselton, Harvey, Pinjarra, Brunswick Junction, Capel and Perth greater metropolitan areas, including Mandurah and two separate non-regulated gas distribution networks, one serving Kalgoorlie and the other serving Albany.

ATCO Australia Pty Ltd is part of the world wide ATCO group of companies with more than 8,000 employees and assets of approximately $12 billion. ATCO's companies are engaged in Utilities (natural gas and electricity transmission and distribution), Energy (power generation, natural gas gathering, processing, storage and liquids extraction), Structures & Logistics (manufacturing, logistics and noise abatement) and Technologies (business systems solutions).

As a significant participant in Australia's energy sector, particularly the gas and electricity markets, ATCO Australia has a close interest in the draft Guideline.

The diversity of the ATCO Australia Group's operations means it has robust ring-fencing arrangements in place for its Australian businesses and is also affected by changes in such arrangements for other sector participants and the operation of energy markets. We are mindful of the need to protect market integrity by separating costs, information and expertise. To that end, several mechanisms already exist such as the cost allocation methodology, ex-ante cost reviews, and assessments of related party transactions. These mechanisms are scrutinised both internally and externally.

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ATCO Australia supports the Energy Networks Association's (ENA) submission on the Guideline. The ENA raises several important issues regarding the necessity of additional regulation, the proportionality of ring-fencing treatments, and the need for clarity of scope and application of the Guideline. We agree that these issues would be best addressed through further direct consultation with stakeholders, ideally through a dedicated workshop with network businesses and other interested parties. We would welcome the opportunity to participate in such workshops, and ensure the potential impact on energy network operators, including both electricity and gas, of any new ring-fencing arrangements is considered.

Though the draft Guideline only covers electricity network service providers under the National Electricity Law, it is reasonable to presume ring-fencing arrangements established for electricity distribution networks and their related companies will set important precedents for ring-fencing of electricity transmission and gas network businesses which will impact other sector participants, existing and potential customers. There are similarities between electricity and gas networks in terms of ownership and operation. However, there are also fundamental differences, such as the provision of natural gas being a non-essential service, and the role of natural gas in renewable and distributed generation technology. These differences mean it may not be appropriate to apply identical ring-fencing arrangements to electricity and gas businesses.

We recommend the AER considers the role of natural gas networks in emerging energy markets, and takes steps to make certain any changes to ring-fencing arrangements also take into account and best promote the National Gas Objective. Our preference would be that any review of ring-fencing arrangements for gas distribution network service providers is conducted via a separate process, which considers the regulatory framework as it applies to natural gas distribution as distinct from electricity, rather than apply the Guideline developed for electricity distribution networks to gas networks.

We consider current ring-fencing arrangements prevent discrimination against other service providers and mitigate the potential for cross-subsidy. We recommend the AER evaluates the effectiveness of existing mechanisms before imposing additional ring-fencing obligations on regulated businesses.

An unintended consequence of the draft Guideline could be to discourage network businesses from pursuing alternative and innovative use of existing assets. This is of particular significance in the gas sector, where the pace and nature of change in the broader energy sector will see the role of natural gas distribution networks adapting and changing to support the sustainability and efficiency of Australia's future energy mix. Changing technology and consumer participation in energy markets requires all energy network operators, including gas network operators to adapt and support such changes. Such adaptation may include enabling development of efficient/innovative gas appliance technology, or supporting standalone renewable generation. It is important that innovation is not prohibited or constrained such that it leads to inefficient network service provision.

We also request the AER provides greater clarity on its definition of 'network services' and its requirement for legal separation of distribution networks from related companies. The draft Guideline does not seem to go so far as to prohibit the group owners of network businesses from offering services that can be obtained in contestable markets. However, we remain concerned that ambiguity around the terms 'non-network services' and 'energy-related services', which feature in the current draft Guideline, may pose a barrier to the group owner's ability to conduct business and serve customers in Australian energy markets.

Clarity is also required on whether electricity and gas network businesses can continue to provide certain types of current services that do not clearly fall within or without the terms of the current draft Guideline. Therefore we support the ENA's recommendation that further dialogue is required on what services are in and out of scope. Where possible, any definitions in the Guideline should be aligned with those in the National Gas/Electricity Rules.

We also recommend the AER facilitates further discussion on the practicability of separating staff under the draft Guideline requirements. Though the draft Guideline indicates some exemptions are feasible, it is not clear whether the exemptions are practicable or whether they achieve a better outcome than current staff-separation arrangements.

For example, ATCO Gas Australia already physically separates their staff from other ATCO Australia Group employees. However, there are some ATCO Australia Group staff who provide services to the ATCO Australia Group businesses and ATCO Gas Australia (for example members of the Legal and Risk teams). This arrangement is in line with the current National Gas Law, which provides that staff who supply technical, administrative, legal and accounting services, or that are involved in marketing pipeline services only as an incidental part of their function, can be shared between ring-fenced entities.

The current draft Guideline implies that to be exempt from physical separation a person must not be directly involved in the provision of regulated services, and ***also*** must not have access to information about customers and services. This requirement may involve significant changes (and associated costs) to the way that ATCO Australia Group and ATCO Gas Australia staff can work, for example, potentially creating duplicate roles in each business. With regard to implementing the Guideline, we recommend the AER engages with network businesses to agree a practicable time frame for transitioning to the new ring-fencing arrangements. While we appreciate the draft Guideline provides up to one year for legal separation and six months for functional separation, these are short lead times for issues that in many cases will require significant and often complex corporate and organisational restructuring, and the development and roll-out of new policies/processes. We also note the draft Guideline does not discuss the transitional period for accounting separation, cost allocation, and information management.

Again, ATCO Australia requests the AER considers the flow-on effect for other participants in the sector, in particular electricity transmission and gas distribution networks, of any precedents set for electricity distribution networks during the finalisation of the Guideline. We echo the ENA's request for a workshop with network businesses and interested parties, and we welcome the opportunity to help ensure the Guideline provides an efficient and workable outcome for all.

Yours sincerely

Simon Byrne
General Manager Corporate Services and Legal