

ELECTRICITY RING- FENCING GUIDELINE

ACTEWAGL RESPONSE TO AER DRAFT GUIDELINE

Version number 1.0 | Date: 28 September 2016

ActewAGL

for you

Table of contents

| | |
|---|----|
| Introduction | 3 |
| Key Issues | 4 |
| Clarifies Terminology and Definitions | 4 |
| Removes Inconsistency with Existing Regulations | 4 |
| Improves the Long Term Interests of Consumers | 4 |
| Submissions on specific proposed clauses..... | 5 |
| 1 Clause 1.3 Definitions and interpretation..... | 5 |
| 2 Clause 3.1 Legal separation..... | 6 |
| 3 Clause 3.2.1 Separate Accounts | 9 |
| 4 Clause 3.2.2 Cost allocation and attribution | 9 |
| 5 Clause 4.1(b) Discrimination | 12 |
| 6 Clause 4.2.1 Physical separation | 13 |
| 7 Clause 4.2.2 Staff Sharing | 16 |
| 8 Clause 4.3 Information | 17 |
| 9 Clause 5 Waivers | 17 |
| 10 Appendix A - Transition | 18 |
| 11 Process toward final guidelines | 20 |

Introduction

ActewAGL Distribution (AAD) welcomes the opportunity to respond to the Australian Energy Regulator's (AER's) Draft Electricity Ring-Fencing Guideline released in August 2016¹ (Draft Guideline).

AAD, a partnership between Icon Distribution Investments Limited and Jemena Networks (ACT) Pty Ltd, owns and operates the electricity distribution network in the Australian Capital Territory (ACT). AAD also owns the gas distribution network in the ACT and adjoining regional areas.

ActewAGL Retail (AAR), a partnership between Icon Retail Investments Limited and AGL ACT Retail Investments Pty Ltd, purchases and retails electricity and gas services in the ACT and NSW in the Capital (including Goulburn, Yass, Young, Nowra and Bega), Shoalhaven and Queanbeyan regions, along with other energy retailers such as Origin Energy Limited and EnergyAustralia Pty Ltd.

Icon Distribution Investments Limited and Icon Retail Investments Limited are both wholly-owned subsidiaries of Icon Water Limited, whose shareholders are the Chief Minister and Deputy Chief Minister of the ACT.

AAD's current ring-fencing obligations are set out in the Ring Fencing Guidelines for Electricity and Gas Network Service Operators in the ACT² (Existing ACT Guidelines). The Existing ACT Guidelines were published by the Independent Competition and Regulatory Commission (ICRC) in 2002, some two years after the establishment of AAD. An overview of these Existing ACT Guidelines is set out in AAD's response to the Australian Energy Regulator discussion paper dated February 2012.³

The Existing ACT Guidelines are broadly comparable with existing guidelines in other jurisdictions. The Existing ACT Guidelines have promoted a robust ring fenced environment in the ACT that incorporates many of the potential elements listed by the AER in the jurisdictional comparison, as set out in the AER's 2011 discussion paper.⁴

Below is a list of key points that AAD considers are the issues of most importance. The key issues section is followed by submissions in relation to specific clauses in the Draft Guideline.

¹ AER 2016 Electricity Draft Ring-Fencing Guideline: August 2016

² <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/jurisdictional-ring-fencing-guidelines>

³ <https://www.aer.gov.au/system/files/ActewAGL%20Distribution%20-%20cover%20letter%20to%20submission%20on%20Discussion%20paper%20-%20distribution%20ring%20fencing%20guideline%20review%20-%202024%20February%202012.pdf>

⁴ AER Electricity distribution ring-fencing guidelines review - discussion paper, 12 December 2011, section 4.2 on pages 22 to 26.

Key Issues

This submission seeks to improve upon the drafting of the ring fencing guideline put forward by the AER for consultation. Each section of this submission refers to a section of the draft ring fencing guidelines and therefore should be read in conjunction with the AER's drafting. AAD's submission seeks to clarify existing terminology and definitions, removes inconsistencies with existing regulations and improves the long term interests of consumers.

Clarifies Terminology and Definitions

This submission provides clarity on terms used in the draft ring fencing guideline by defining them where no definition currently exists and relying on the existing definitions of terms in the National Electricity Rules (NER) and National Electricity Law (NEL).

Removes Inconsistency with Existing Regulations

The proposed drafting removes obligations from the ring fencing guidelines that are already present in other regulatory requirements.

Improves the Long Term Interests of Consumers

The proposed changes in this submission better serve the long term interests of electricity consumers than the AER's drafting because they:

- allow consideration of efficiencies derived from economies of scale and consideration of the costs and benefit for applying obligations;
- clarify unclear obligations;
- narrow unnecessarily broad drafting; and
- create legal certainty where conflict could otherwise emerge.

Submissions on specific proposed clauses

1 Clause 1.3 Definitions and interpretation

Network services

The use of the term 'network services' in clause 3.1 of the Draft Guideline creates significant confusion because the use of this term appears inconsistent with the AER's Explanatory Statement. In particular, it does not appear on the diagram in Figure 1 on page 15. AAD has proceeded on the basis that the AER intended that the term 'network services' as used in the Draft Guideline has the same meaning as the combination of 'distribution service' and 'transmission service' as those terms are defined in the NER.⁵ The term 'network service' (as defined in the NER) is significantly narrower than the combination of the terms 'distribution service' and 'transmission service' (as defined in the NER) because of the words of limitation at the end of the definition of 'network service'.

In any event, clause 3.1 requires significant amendment as outlined in the relevant section below.

Energy-related services

This term is used in bold in the Draft Guideline which is said to mean that the term takes the meaning as defined in the NER.⁶ However, the NER does not define 'energy-related services'. AAD proposes removing this term.

Staff directly involved in the provision of

The term 'staff directly involved in the provision of' should be defined as meaning staff who, in providing the relevant services, have direct contact with customers and have access to customer data at an individual customer level.

⁵ The Explanatory Statement contains numerous examples of this intention including in Table 1, Figure 1, page 23 and case study 6.

⁶ Draft Guideline, clause 1.3.

2 Clause 3.1 Legal separation

2.1 Requirement for legal entity is unnecessary and uncertain

Clause 3.1(a) requires a DNSP to be a legal entity. This obligation should be removed. It is not necessary to achieve the stated objectives⁷ and creates a number of practical difficulties which could result in ACT consumers bearing unnecessarily higher costs, receiving a lower quality of services, or both.

AAD is a partnership. At law, it is unclear whether a partnership is a 'legal entity'.⁸ The term 'legal entity' is not defined in the Draft Guideline and has no accepted meaning at law.⁹

A partnership structure does not create or in any way contribute to any of the potential harms the Draft Guideline is directed to. In consequence, it is unnecessary for the Draft Guideline to impose this obligation.

2.2 Prohibition on DNSPs providing services is unnecessarily broad

Clause 3.1(a) of the Draft Guideline prohibits a DNSP from doing anything other than providing 'network services'. This restriction is both unnecessarily broad and creates real practical problems. For example, it would:

- Prevent DNSPs from providing services that they are required to provide by the NER. One of the many examples is that the NER require DNSPs to provide 'connection services' to retail customers.¹⁰ The AER has expressed the view that 'connection services' are not 'network services'.¹¹ As such, clause 3.1(a), as currently drafted, would create a conflict for DNSPs in that they could not simultaneously comply with the Draft Guideline and the NER.
- Prevent AAD from providing regulated or natural monopoly gas distribution services. AAD owns several gas distribution networks, whose operation and maintenance is outsourced. Limiting a DNSP to providing 'network services' would create a need for a corporate restructure to divest AAD's gas networks. That would result in unnecessary and inefficient costs associated

⁷ Clause 1.1 of the Draft Guideline states that its objectives are the accounting and function separation of the provision of direct control services by DNSPs from other services provided by them or their related bodies corporate.

⁸ The High Court held that a partnership is not considered a separate entity distinct from the individuals who compose it (*Rose v Federal Commissioner of Taxation* [1951] 84 CLR 118 at 124-125).

⁹ The Corporations Act 2001 (Cth) (Corporations Act), in the context of related party transactions, defines an 'entity' as including a partnership. We consider the term 'entity' is potentially distinct from the term 'legal entity'.

¹⁰ See for example, NER, r5A.B.1(a).

¹¹ AER Stage 1 Framework and Approach Paper ActewAGL March 2013, at page 8, 'Most distribution services fall within the network services group, which include poles, wires, and other core infrastructure of a distribution business. These are central to ActewAGL's business and are used by the broad customer base. We will classify ActewAGL's network services as direct control services because they are central to ActewAGL's monopoly power and are frequently subject to licence restrictions. We will also classify ActewAGL's connection services as direct control services'.

with a corporate restructure being incurred. There is no possible benefit that might outweigh those costs. For example, there is no possible competition benefit from requiring AAD to legally separate its regulated gas distribution business from its regulated electricity distribution business. Those businesses are monopoly businesses and not subject to competition.

- Prevent DNSPs from efficiently utilising shared assets to provide services to other businesses and thereby collect revenue which is used to lower the cost of electricity distribution services for consumers. For example, the Shared Asset Guidelines envisage that DNSPs may:
 - Provide services to telecommunications companies in the form of space on power poles to hang fibre optic cables.¹²
 - Provide services to electric vehicle companies in the form of space on an electricity distribution transformer for an electric vehicle charging station.¹³

2.3 Operation of Shared Asset Guideline is unclear under current clause 3.1 drafting

The Shared Asset Guidelines provide for DNSPs to make efficient use of their assets by charging other businesses for 'shared' use of those assets. In practical terms, the DNSPs provide a 'non-distribution service' to third parties and use the revenues generated to reduce the cost of 'distribution services' to electricity consumers. As is discussed above, clause 3.1(a), as currently drafted, would seem to render the Shared Asset Guidelines otiose, and consequently increase the cost of 'distribution services' for end users. That outcome is inconsistent with the shared asset principles set out in the NER. Specifically, clause 6.4.4(c)(1) of the NER provides:

the Distribution Network Service Provider should be encouraged to use assets that provide standard control services for the provision of other kinds of services where that use is efficient and does not materially prejudice the provision of those services

2.4 Potential alternative drafting of clause 3.1(a)

If a legal separation obligation is to be included in the final guideline, it should be drafted as follows:

A DNSP may provide **distribution services** and **transmission services** but must not provide any other **electricity services** that are contestable to **end users**.

(Bolded terms take the meaning set out in definitions section of the NER or the NEL as applicable)

¹² AER, Shared Asset Guideline, November 2013, page 4.

¹³ AER, Explanatory Statement, Shared Asset Guideline, November 2013, page 8.

The above drafting has the following features:

- This drafting makes it clear that DNSPs can provide not only 'network services', but also other services falling within the NER defined terms 'distribution services' and 'transmission services'.¹⁴ DNSPs are obliged by the NER to provide 'distribution services'. The AER recognised this requirement in its Explanatory Statement.¹⁵
- The restriction on a DNSP's activities relates only to electricity services. This is consistent with the stated objective of the Draft Guideline to 'promote the National Electricity Objective'¹⁶ (which objective relates exclusively to electricity). The National Electricity Objective is not concerned with promoting competition in markets for other industries such as gas, telecommunications, rail, etc.
- DNSPs are not precluded from making efficient use of assets that can be shared by providing services to other businesses (for example, making space on poles available to telecommunications companies). The ability to provide such services with shared assets is efficient, it is in the interests of electricity consumers because it lowers costs for them, and it is encouraged by the existing NER.
- The restriction on a DNSP's activities relates only to services provided to end users. This is consistent with the apparent intent of the Draft Guideline. For example, the Explanatory Statement observes:

"The new guideline will underpin the increasingly important role third party service providers will play in the supply of metering and other network services to consumers."¹⁷

- The restriction on a DNSP's activities relates only to services that are contestable. This is consistent with the intent of ring-fencing. For example, the Explanatory Statement records that:

'Ring-fencing is the identification and separation of business activities, costs and revenues within an integrated entity associated with regulated monopoly services, from services provided in a competitive market.'¹⁸

2.5 Clarification that clause 3.1 does not prevent staff sharing

A new clause 3.1(f) should be added to clarify that staff sharing may occur, provided that it complies with the ring-fencing requirements. That new clause should read as follows:

¹⁴ The NER defined term 'network services' is a subset of the NER defined terms 'distribution services' and 'transmission services' being those services that are associated with conveyance, and controlling the conveyance, of electricity through the network.

¹⁵ AER, Draft Ring-fencing Guideline Explanatory Statement, August 2016 at page 23 where the AER stated: 'A DNSP must be able to provide all distribution services, regulated and unregulated, as well as regulated transmission services (where relevant), in order to meet its obligations under the NER.'

¹⁶ Draft Guideline, clause 1.1.

¹⁷ AER, Draft Ring-fencing Guideline Explanatory Statement, August 2016 at page 8.

¹⁸ AER, Draft Ring-fencing Guideline Explanatory Statement, August 2016 at page 1.

(f) For the avoidance of doubt, clauses 3.1(a) and (b) do not prevent a DNSP sharing its **staff** including by those **staff** undertaking work for another entity, including a **related body corporate**, pursuant to an agreement with that other entity.

In the absence of this clause, there is a risk that the ring-fencing guideline could be interpreted as precluding DNSPs engaging in efficient staff sharing because of the obligation imposed by clause 3.1(a).

For example, AAD has legal staff that are involved in providing legal advice regarding electricity distribution services but also provide advice regarding the gas industry and the water industry. This kind of staff sharing creates significant efficiencies because the specialist skills of those staff are able to be used to their full extent, which goes beyond electricity distribution.

The intention of the Draft Guideline is that staff sharing is addressed in clause 4.2.2 rather than clause 3.1.

There would be detriment to consumers if clause 3.1 was interpreted as precluding a member of a DNSPs staff from being efficiently shared with a related body corporate (ie inadvertently over-riding the position established in clause 4.2.2). That detriment would arise because of increased costs incurred by service providers.

Consequently, a new clause 3.1(f) should clarify the position by making clear that a DNSPs staff may be shared. Clause 4.2.2(a) and (c) will continue to apply to regulate the sharing of certain staff.

3 Clause 3.2.1 Separate Accounts

3.1 Ring-fencing guideline cannot expand the AER's power to issue regulatory information instruments

Clause 3.2.1(b) of the Draft Guideline should be removed. The NEL confers upon the AER the power to issue regulatory information instruments to 'network service providers' or 'related providers' where it considers doing so is reasonably necessary for the performance or exercise of its relevant functions or powers.¹⁹ The ring-fencing guideline cannot expand the power of the AER to issue regulatory information instruments. In consequence, clause 3.2.1(b) is unnecessary and should be removed.

4 Clause 3.2.2 Cost allocation and attribution

4.1 No need for cost allocation requirement because this is addressed by the CAM

Clause 3.2.2 of the Draft Guideline should be deleted in its entirety because it is unnecessary and, further, clauses 3.2.2(a) and (b) are inconsistent with the existing CAM which creates legal uncertainty.²⁰

¹⁹ NEL, s28F.

²⁰ The cost allocation principles in AAD's approved CAM are different from considerably more comprehensive than the proposed clauses 3.2.2 (a) and (b) in the Draft Guideline.

The Explanatory Statement contends that it is necessary for the Draft Guideline to include requirements in respect of cost allocation because of:

a gap created by legal limitations which currently limit the scope of the Cost Allocation Guideline and CAMs to the attribution and allocation of costs between categories of distribution services (i.e. not between distribution and non-distribution services)²¹

No such gap exists for the reasons set out below including that AAD's approved CAM covers the allocation of costs between distribution and 'non-distribution' services. Clause 6.15.1 of the NER provides that a DNSP must comply with its approved CAM. The CAM must be consistent with the cost allocation guidelines, which in turn must be consistent with the cost allocation principles²², including clause 6.15.2(3) which provides that:

(3) only the following costs may be allocated to a particular category of *distribution services*:

(i) costs which are directly attributable to the provision of those services;

(ii) costs which are not directly attributable to the provision of those services but which are incurred in providing those services, in which case such costs must be allocated to the provision of those services using an appropriate allocator which should:

(A) except to the extent the cost is immaterial or a causal based method of allocation cannot be established without undue cost and effort, be causation based; and

(B) to the extent the cost is immaterial or a causal based method of allocation cannot be established without undue cost and effort, be an allocator that accords with a well accepted cost allocation method;

The above cost allocation principle provides that a DNSP may not allocate to any category of distribution services (including direct control services) any cost which is neither directly attributable to the provision of distribution services nor incurred in providing those services (**Costs Relating To Non-Distribution Services**).

In consequence, the above principle, through the approved CAM, precludes a DNSP from allocating to direct control services (or any other distribution services) Costs Relating To Non-Distribution Services.

Thus, the approved CAM precludes a DNSP from cross subsidising between distribution and non-distribution services (for example by allocating to distribution services Costs Relating To Non-Distribution Services).

²¹ Explanatory Statement, page 27.

²² NER clause 6.15.4(b) and 6.15.3(b).

The AER is assured that the DNSP is applying the approved CAM and cost allocation principles correctly through the audit and verification requirement set out in clause 3.2(a)(7) of the AER's Cost Allocation Guidelines.

4.2 AAD's approved CAM prevents cross-subsidisation

AAD's existing CAM is a case in point. The AER found that AAD's current CAM allocates costs between direct control services, negotiated distribution services and unclassified or unregulated distribution services.²³ That is, it deals not only with the allocation of costs to direct control services and negotiated distribution services, but also to unregulated distribution services.

AAD's current CAM also covers the allocation of costs between AAD and other entities, such as AAR.²⁴ AAD's CAM provides that it maintains all financial source documentation and financial records and that an annual audit is undertaken by an external auditor.²⁵ Further, AAD's CAM explains the drivers of cost allocations to substantiate them.

The CAM therefore sets out the basis upon which costs may be allocated to distribution services, and, importantly, therefore also sets out the corollary (ie the costs which may not be allocated to distribution services).

As such, AAD's existing CAM prevents AAD from cross subsidising (for example by allocating to distribution services costs properly attributable to non-distribution services).

The AER has the power to approve, or refuse to approve any future CAM that AAD, and other DNSPs, submit for approval.²⁶

4.3 Clause 3.2.2 cannot regulate or require the provision of accounts from entities other than DNSPs

Neither clause 3.2.2, nor any other part of the Draft Guideline does, nor can, apply to impose a cost allocation methodology on a related body corporate of a DNSP. The AER's regulatory power is limited to regulating the DNSP.²⁷

In the event that AAD employs an accountant who is shared equally between AAD and a related entity (XZY), then AAD may decide to allocate 50% of that employee's wage to its distribution business and 50% to XYZ. In that scenario, AAD's accounts will show a salary expense being 50% of the employee's wage. The decision to allocate 50% to AAD (and to its distribution business) would be made pursuant to the detailed provisions of the CAM and is subject to the audit requirements in the

²³ AER Final Decision ActewAGL Distribution Revised Cost Allocation Method, June 2013, page 5.

²⁴ AAD Cost Allocation Methodology, November 2012 states, at page 5: "The proposed CAM also covers the allocation of costs to the electricity network business from other parts of ActewAGL."

²⁵ AAD Cost Allocation Methodology, November 2012, section 5.1.

²⁶ NER, clause 6.15.4.

²⁷ NER, clause 6.17.1. This clause imposes an obligation on a DNSP. It does not impose any obligation on a related body corporate of a DNSP.

CAM. It is not necessary for the AER to review the financial statements of XYZ to verify this transaction.

4.4 Clause 3.2.2(a) creates legal uncertainty

Further, clause 3.2.2(a) of the Draft Guideline creates a problem by introducing a new obligation which is inconsistent with AAD's existing obligations. Specifically:

Clause 3.2.2(a) of the Draft Guideline provides that:

a **DNSP** must not allocate or attribute to **distribution services** any costs that properly relate to **non-distribution services**.

The 'properly relate' test in clause 3.2.2(a) is not the same as, and therefore potentially inconsistent with, the requirements as to cost allocation methodology set out in AAD's approved CAM (which includes a number of approaches to allocation including a 'directly attributable test'). Specifically, the allocation methodology in AAD's approved CAM does not use the words 'properly relate'.

4.5 Conclusion on clause 3.2.2

For the reasons set out above, clause 3.2.2 of the Draft Guideline is not necessary in respect of AAD, or any other DNSP, and should be removed.

If the final guideline retains some parts of clause 3.2.2, clause 3.2.2(a) should be removed because it is inconsistent with clause 3.2.2(b) and the CAM. Clause 3.2.2(b) covers the field and makes clause 3.2.2(a) unnecessary.

5 Clause 4.1 Discrimination

5.1 Limit the application of the anti-discrimination requirement to electricity services

Clause 4.1(a) should be amended to limit its application to 'electricity services'.

Clause 4.1(a) currently applies to 'non-distribution services'. That term is not currently defined but potentially applies to services beyond 'electricity services'. It is not necessary or appropriate that the final guideline apply beyond electricity services. The National Electricity Objective is not concerned with promoting competition in markets for other industries.

In consequence, clause 4.1(a) should be redrafted as follows:

A **DNSP** must not discriminate (either directly or indirectly) between its **related body corporate** (including customers of its **related body corporate**) and competitors of its related body corporate (including customers of a competitor of its **related body corporate**) in connection with the supply of **electricity services**.

5.2 Clarifying the obligation to provide substantially the same quality, reliability and timeliness

Clauses 4.1(b)(ii) and (iii) should be amended by adding at the start the words 'endeavour to'.

We take clause 4.1(b)(iii) as an example. Despite the best of intentions, it is possible as a matter of practice, that on a particular day, or for a particular customer, AAD's service to a competitor takes longer than a similar service provided to its related body corporate. That might be simply due to chance, or it could be a result of the competitor making it difficult for AAD (for example by providing insufficient or incorrect information, insufficient notice of the likely need for a particular service on a particular day, or failing to inform their customer of the need to be at home at the right time to allow the performance of a service).

In circumstances where AAD is endeavouring to provide services equally to all competitors (including its own related body corporate), it would be unreasonable if AAD breaches the ring-fencing guideline due to chance occurrences or improper planning by a competing party.

The same considerations apply in respect of clause 4.1(b)(ii).

In consequence, the obligations should be reframed to focus on a DNSP's intent. This approach is consistent with clause 4.1(b) providing examples of the obligation in clause 4.1(a). A strict liability regime divorced from the intent of the DNSP would go beyond the ordinary meaning of the obligation in clause 4.1(a).

5.3 Clarity as to separate branding requirements

Clause 4.1(b)(vi) should be amended in the following way to provide clarity:

have branding which distinguishes between the **DNSP** and a **related body corporate** that provides **electricity services** that are contestable to **end users**. For the avoidance of doubt, this does not prevent the use of a corporate brand provided it is no more prominent than the distinguishing brand on any product packaging or in any advertising material.

Branding occurs in many places, from newspaper reports and websites, to television advertisements and t-shirts. If a DNSP owns an electricity metering provider, it is simply not possible to entirely separate their respective brands. For example, many companies set out their ownership structure on their website. A failure to do this may undermine consumer confidence in the company.

Any obligation in relation to branding must be commercially realistic and recognise that it is not possible to entirely divorce the branding of two entities that are related bodies corporate.

6 Clause 4.2.1 Physical separation

6.1 A requirement that AAD and related bodies corporate operate from separate buildings is unnecessary

Clause 4.2.1(a) should be amended to read:

'A **DNSP** must ensure that its **staff** directly involved in the provision of a **direct control service** or regulated **transmission service** work in separate offices from the offices in

which any staff of any **related bodies corporate** who are directly involved in the provision of other **electricity services to end users** work.

In this clause, 'separate offices' means:

1. Offices that are in physically separate buildings; or
2. Offices that have separate and secure access requirements such that staff from one office does not have unescorted access to the other office.'

Clause 4.2.1(b) should be amended to read:

'The obligation set out in clause 4.2.1(a) is subject to the same exceptions as are set out in clause 4.2.2(b)'.

A physical separation requirement is appropriate provided it is clear how this requirement applies in practice. The proposed drafting above seeks to provide this clarity without detracting from the substance of the approach set out in the Draft Guideline. In particular, this proposed drafting clarifies the following issues:

- The obligation for physical separation should focus on the people that are providing the service rather than the location of the corporate entity. That approach aligns with the exceptions, in clause 4.2.1(b), which focus on staff.
- The obligation for physical separation should not prevent a DNSP and a related body corporate having offices on different floors of a multi-storey building, provided that access is restricted. The optimal way to structure physical separation of offices is by limiting physical access to the offices. Separate buildings does not necessarily achieve the required physical separation. For example, staff from a DNSP could occupy a building that is immediately adjacent to a separate building housing staff from a related contestable business but which has no relevant security arrangements or access protocols. If staff from the DNSP can freely enter the separate building, that would not appear to achieve the apparent underlying objective of this clause.
- The Draft Guideline identifies 'staff directly involved in the provision of' direct control services and provides an exception for staff who are not.²⁸ This is appropriate provided there is sufficient clarity as to which staff are subject to the ring-fencing guideline. AAD employs staff who undertake a range of activities including payroll, finance, legal, IT support, occupational health and safety and human resources. Although these staff are critical to AAD's ability to provide direct control services, they do not visit customers, substations or other sites critical to the operation of the network to acquire information that could be used for an anti-competitive purpose and are not in a position to confer any competitive advantage on a related body corporate in a contestable market. As such:

²⁸

Explanatory Statement at page 37, states 'This exception is warranted because we consider there is a low risk of (and incentives for) such staff assisting a related body corporate or a service provider to gain an inappropriate competitive advantage in the market for competitive or contestable energy-related services'.

- the term 'staff directly involved in the provision of' should be defined as set out above in clause 1.3.
- the reference in the Draft Guideline to staff who do not have access to information about electricity services should be removed or clarified because all staff, and indeed the public, has information about electricity services.
- The term 'its separate service providers' is not defined. However, a DNSP does not have the ability to control other entities that are not related bodies corporate. As such, it is not possible for a DNSP to control the location in which a separate service provider establishes an office. It would be inappropriate for a DNSP to be put into breach of the ring-fencing guideline as a result of conduct of a separate service provider over which the DNSP has no control (such as establishing an office in the same building as the DNSP).

6.2 Energy-related services definition

The term 'energy-related services' is not defined in the NER. It should be replaced in the guideline by the phrase '**electricity services** provided to **end users**' adopting the definitions in the NEL.

There is a risk that the term 'energy-related services' which currently appears in the Draft Guidelines could be interpreted in a way that is unnecessary for the promotion of, or irrelevant to, the "long term interests of consumers of electricity"²⁹. For example, it could be interpreted as extending to gas services. AAD owns several gas distribution networks. Electricity and gas services are distinct and separate in the same way that electricity and telecommunications services are separate and distinct. It is very unlikely that AAD staff, by virtue of AAD's role in relation to a monopoly electricity distribution network, could confer a competitive advantage on a related body corporate in any other industry including, for example, the telecommunications or gas industries. In any event, it is not the function of these guidelines to become concerned in competition or consumer issues in industries other than electricity. Further, any potential risk of inappropriate subsidisation by a DNSP of an entity in the gas or other industry is covered by the operation of the CAM, and clause 6.15.2(3) of the NER, as explained above.

6.3 The exception in clause 4.2.1(b) should be the same as those covered by clause 4.2.2(b)

The exception in clause 4.2.1(b) is currently more limited than the exception in clause 4.2.2(b). There seems no policy reason, and it would be inefficient and impractical, for members of staff who may be shared under clause 4.2.2 (in particular those referred to at 4.2.2(b)(ii) and (iv)) to be required to maintain two separate offices under clause 4.2.1.

²⁹

As required by the national electricity objective in section 7 of the NEL

7 Clause 4.2.2 Staff Sharing

7.1 Clarity as to which staff are 'directly involved in the provision of' direct control services and regulated transmission services

As is set out above in relation to clause 4.2.1(b), AAD employs a range of staff who undertake a range of advisory and support activities that are critical to AAD's ability to provide efficient direct control services, and regulated transmission services but do not visit customers, substations or other sites critical to the operation of the network and are not in a position to confer any competitive advantage on a related body corporate in a contestable market. For example, this would include staff working in payroll, finance, legal, IT support, work health and safety and human resources.

As such, the term 'staff directly involved in the provision of' should be defined as set out above in clause 1.3.

This proposed definition removes the reference in the Draft Guideline to staff who do not have access to information about electricity services. That is because all staff, and indeed most of the public, have information about electricity services.

7.2 Clarity as to what are 'competitive or contestable energy-related services'.

The term 'competitive or contestable energy-related services' lacks clarity. The terms competitive and energy-related are not defined in the NER and although the term 'contestable' is defined in the NER, that term has not been bolded in the Draft Guideline which suggests that it takes a different meaning from that set out in the NER (although the lack of definition makes it unclear how that meaning differs). It should be replaced in the guideline by the phrase '**electricity services** that are contestable provided to **end users**' adopting the definitions in the NEL and in alignment with the proposed re-draft of clause 3.1a).

7.3 Clarity as to what is intended by clause 4.2.2(b)(iv).

The exception in clause 4.2.2(b)(iv) should be clarified by making the following changes to the drafting.

'For the avoidance of doubt, a member of **staff** who is involved in the provision of a **DNSP's negotiated distribution services**, unregulated distribution services or unregulated **transmission services** but is not directly involved in the provision of a **direct control service**'

These changes would make clear that:

- The exception applies not only to staff who provide both negotiated distribution services and unregulated distribution services, but also to staff who provide either one of those services.
- The exception does not apply to staff directly involved in the provision of direct control services.

- The exception is for the avoidance of doubt. This is because staff who are not directly involved in the provision of direct control services are not subject to clause 4.2.2(a).

8 Clause 4.3 Information

8.1 Inclusion of an exception for requirements of law or the NER

Clause 4.3 should include exceptions in respect of requirements of law or requirements of the NER.

These standard exceptions would ensure that DNSPs are not put in breach of the ring-fencing guidelines as a result of complying with other binding obligations. For example:

- If, in legal proceedings, a Court ordered a DNSP to provide information, it would not be appropriate for the DNSP to be put into breach of the ring-fencing guidelines as a result of complying with a Court order.
- The NER requires a DNSP to collect various data (such as metering data) which information is made available to various other parties specified in the Rules, including a customer's retailer.³⁰ In circumstances where a customer's retailer is a related body corporate of the customer's DNSP, the DNSP should not be put in breach of the ring-fencing guidelines as a result of compliance with the NER.
- In order to respond to a regulator about a customer complaint or investigation.

9 Clause 5 Waivers

9.1 Potential waivers for all requirements in the guideline including in particular clause 3.1.

The final guideline should allow a DNSP to apply for a waiver in respect of the application of all clauses in that guideline.

Adding an ability for a DNSP to apply for a waiver to the Draft Guideline could have no detrimental impact in respect of the objectives of the Draft Guideline because the AER would ultimately determine whether it is appropriate to grant a waiver.

However, it would have the significant benefit of creating flexibility by conferring upon the AER an ability to grant a waiver in respect of specific circumstances where the applicant is able to demonstrate that the benefit of a waiver would outweigh the cost of complying with the position set out in the guideline.

³⁰ See for example NER, r7.7(a).

9.2 Time limit for AER to determine waiver applications

Clause 5.2.3 should include a requirement that the AER is deemed to accept a waiver application unless it has made a decision to refuse the application within 4 months of receiving an application that complies with clause 5.1.

9.3 Removal of the words cross-subsidisation in clause 5.2.2(a)(ii).

If the right to seek a waiver is not extended as suggested above, then clause 5.2.2(a)(i) should be amended by removing the words 'cross subsidisation and'. As currently drafted, the Draft Guideline limits waivers to functional separation requirements, which are not designed to avoid cross-subsidisation.³¹ As such, consideration of the potential for cross-subsidisation would not appear to be relevant to an application for waiver of a functional separation requirement.

10 Appendix A - Transition

10.1 Twelve month transition for rebranding obligation

Appendix A should be amended to include a transition period of at least 12 months in respect of the rebranding obligation set out in clause 4.1(c) of the Draft Guideline.

Rebranding is a large commercial project. Any requirement to do so would take at least 12 months³². This project would include designing new branding and replacing all existing branding (including branding on billboards, television commercials, brochures, websites, business cards, branded equipment).

10.2 Twelve month transition for functional requirements

Appendix A, clause (b) should be amended to make clear that the transition period for the functional requirements set out in clauses 4.2.1 and 4.2.2 is 12 months.

This is consistent with the view expressed by the AER in its Explanatory Statement that it is reasonable to allow a period of up to one year for DNSPs to comply with functional separation obligations.

Further, a 12 month transition period is consistent with the commercial reality. Staff employment arrangements are complex and where DNSPs are required to alter the roles of employees, they will need to do so in accordance with employment contracts and industrial relations laws. Employing new staff takes time. DNSPs should not be forced into employing staff into new roles who are not adequately qualified for those roles as a result of the ring-fencing guidelines. Any transition period shorter than a year would create a serious risk of inefficiencies arising.

10.3 Extended transition period for any existing arrangements in respect of which the AER refuses to grant an application for waiver

Appendix A should be amended as follows:

³¹ Explanatory Statement, page 3.

³² The activities associated with the re-branding of Icon Water took longer than 12 months.

(a) The obligations set out in clause 3.1(a), 4.1(c), 4.2.1 and 4.2.2 commence on a date that is 12 months after the commencement date provided in clause 1.1

(b) Notwithstanding clause (a) above, in circumstances where, within 3 weeks of the commencement date provided in clause 1.1, a **DNISP** applies for a waiver in respect of arrangements in existence as at 1 July 2016 then, in the event that the AER ultimately refuses to grant that waiver, the relevant obligations will commence 12 months after the date that the AER notifies the DNISP of its refusal to grant that waiver.

(c) a 12 months transition applies to a distribution service that becomes contestable before the DNISP ceases to provide the distribution services.

It is appropriate to extend the transition period in respect of existing arrangements because:

- There is at least a reasonable chance that a waiver will be granted in respect of such arrangements because those arrangements comply with existing ring-fencing guidelines.
- The AER may not be in a position to determine whether or not to grant the waiver application for a number of months because there may be a number of waiver applications lodged virtually simultaneously and the AER may decide to undertake public consultation.
- It would be inefficient for DNISPs to be required to commence work on changing existing arrangements to comply with the transition period in circumstances where the DNISPs if they have applied for a waiver in respect of those arrangements and are awaiting a decision from the AER.
- The existing arrangements comply with existing ring-fencing guidelines and are therefore unlikely to create harm in contestable markets.

10.4 Costs of compliance with guideline will be a pass through event

The Explanatory Statement recognises that costs relating to non-discrimination measures will sit with the affected entity.³³

There could also be costs arising from other requirements of the ring-fencing guidelines. For example, any obligation to create legally separate businesses may result in corporate restructuring costs. This could include a variety of costs including costs associated with staff redundancies, asset sales, tax, creation of new corporate entities, staff retraining, new offices, including office fit-outs, and business restructuring costs. Many of those costs will sit with the DNISP. In consequence, AAD anticipates that a pass through event will arise as a result of the ring-fencing guidelines being published and AAD taking steps necessary to comply with those guidelines.

³³

Explanatory Statement, page 55.

11 Process toward final guidelines

As a result of the issues set out above, AAD considers there is the potential for significant change between the Draft Guideline and the next version of the guideline.

In that circumstance, AAD would request that industry participants be provided with an opportunity to comment on a revised version of the guideline before a final guideline is published by 1 December 2016. To facilitate this, the AER should publish the next version of the guideline in sufficient time for a further consultation, even if that consultation is only for a short period.