Locked Bag 14051
Melbourne City Mail Centre
Victoria 8001 Australia
T: 1300 360 795
www.ausnetservices.com.au

30 May 2016

Mr Chris Pattas
General Manager, Network Operations and Development
Australian Energy Regulator
GPO Box 520
Melbourne Victoria 3001

Via email: Ringfencingguideline2016@aer.gov.au

Dear Chris

Re: Ring-fencing Guideline: Preliminary Positions Paper

We are pleased to have the opportunity to contribute into this initial phase of the AER's development of ring-fencing guidelines for Distribution Network Service Providers (DNSPs). AusNet Services is a diversified network services business, which owns and operates electricity and gas distribution networks and the electricity transmission network in Victoria.

There is considerable interest in the formation of new guidelines at a time when significant transformation within the energy sector is occurring, driven by customer choice which has been enabled through technology advances and information accessibility. This provides opportunities for innovation in new and enhanced services and for the development of innovative and efficient ways to enhance bulk network services. Whilst significant change has already occurred it can only be expected to accelerate with more customers looking to actively participate in distributed energy resources (DER).

The scope of future services, and the participants in the markets that will provide them, cannot yet be entirely foreseen. In these markets the NSP may act as the market maker (e.g. platform for new generation dynamic energy services). It would be premature to seek to constrain the evolution of the most effective and efficient arrangements, via ring-fencing prohibitions.

There are also many instances where networks operate in well-established markets and where precipitous and disproportionate regulation would increase costs, damage or limit competition and leave customers of both regulated and contestable services, considerably worse off. This includes situations where:

- the NSPs are themselves the main competitors in a market (e.g. unregulated transmission);
- the NSP's activities increase competition in another market characterised by dominant players (e.g. telecommunications);

- the NSP provides essential services across the networks sector (e.g. asset testing and laboratory services).

The risk is that the economic benefits to be realised from this transformation could become constrained by regulations. The interests of customers will be best served by ring-fencing arrangements that accommodate the many value facets of network services and hence do not unduly restrict these activities and dampen innovation within the network sector.

Measures to mitigate the potential for an NSP to confer an unfair advantage in a contestable market because of its provision of regulated services therefore must be proportionate to the potential harm that may arise from the NSPs participation in those markets. It is essential that such measures do not arbitrarily reduce competition, which would be to the detriment of customers of both regulated and contestable services.

In summary AusNet Services considers that for the arrangements to be consistent with the NEO they should focus more clearly on customer outcomes than indicated by the Preliminary Positions Paper, and be based on the principles of proportionality and functionality.

Our detailed submission is attached.

We look forward to continuing to engage with the AER in the guideline development process. If you have any queries regarding our submission we would be pleased to discuss these with you.

Yours sincerely,

Tom Hallam
Manager Regulation and Network Strategy

AusNet Services Submission
Ring-fencing Guideline: Preliminary Positions Paper

Whilst the ring-fencing guideline that the AER is consulting on will be applicable to DNSPs the AER notes that it would expect the guideline for Transmission Network Service Providers to be very similar. In this submission we therefore use examples and discuss the circumstances pertaining to transmission network services as well as to distribution network services.

1. Coverage of Ring-Fencing Obligations

The ring-fencing obligations proposed by the AER in the Preliminary Positions Paper are reproduced below.

Box 1: AER Proposed Ring-fencing Obligations

The following obligations are designed to assist in achieving the ring-fencing objectives. A DNSP providing direct control services must:

(a) not carry on a ring-fenced service unless it is within a separate legal entity to the DNSP,

(b) not locate a ring-fenced service at the same physical location as the DNSP

(c) not share staff between the ring-fenced entity and the DNSP

(d) establish and maintain separate accounts that clearly identify the extent and nature of transactions between the NSP and ring-fenced entity(s)

(e) ensure there is no cross subsidy between the ring-fenced entity and the DNSP

(f) protect information provided by a customer or prospective customer and ensure its use is only for the purpose for which that information was provided

(g) ensure that information provided to a ring-fenced entity is also available to third parties an equal basis

(h) ensure information obtained by the DNSP is not disclosed to any party without the informed approval of the customer or prospective customer to whom it pertains

Source: AER Preliminary Positions Paper, Section 4, pages 26-27

The ring-fencing obligations as outlined are comprehensive and in effect ban Network Service Providers (NSPs) from operating in markets that are not direct control services. However, it is not clear that the approach has regard to, and would integrate into, the overall regulatory system governing monopoly services. Having clear recognition of other elements of the system will facilitate a guideline that complements the features of the overall system.

Existing Regulatory Controls

Regulatory system elements which already provide effective mechanisms to achieve appropriate accounting and functional separation to meet ring-fencing objectives in the majority of circumstances include:

- National Electricity Rules economic regulation provisions:

- Shared asset guideline;
- Regulatory accounts and RIN data provision;
- Cost Allocation Methodolgy;
- Demand Side Engagement Strategy;
- Annual network planning process;
- Regulatory investment test;
- Capital Expenditure Incentive Guideline;
- Efficiency Benefit Sharing Scheme; and

- the mergers and acquisitions and use of market power provisions of the Australian Competition and Consumer Act (2010).

These existing mechanisms provide appropriate safeguards, ensuring behavior does not lead to inefficient market outcomes, in situations where NSPs already play a legitimate and important role in the provision of non-regulated services in well-established competitive markets, i.e. where:

- the NSPs are themselves the main competitors in a market (e.g. unregulated transmission);
- the NSP's activities increase competition in another market characterised by dominant players (e.g. telecommunications);
- the NSP provides essential services across the networks sector (e.g. asset testing and laboratory services).

In the above circumstances the imposition of the obligations proposed by the AER, and prohibiting NSP participation in such services leads to loss of economic benefit, and to customers in both regulated and unregulated markets being considerably worse off.

In contrast, the approach proposed by the AER adopts the assumption that preventing NSPs from competing in those other markets and, therefore restricting competition, would be in the best interest of consumers, of both regulated and contestable services. The approach presumes that all such markets are certain to develop deep and vigorous competition if NSPs are excluded. The only certain beneficiaries of such an approach are non-NSP participants. The impact on consumers is likely to be detrimental in many instances.

A more flexible approach to ring-fencing would ensure that the accounting and functional separation measures are selected according to the circumstances of the services, such that the most beneficial outcomes for customers are fully considered. AusNet Services views for such an approach are discussed in Section 2.

The following sub-section provides examples of resource sharing by the NSP encouraged by the current regulatory framework and which deliver beneficial outcomes for customers.

Resource Sharing in Provision of Network Services

We understand that the AER proposes the ring-fencing obligations should apply in the broadest sense, i.e. including for services provided by the NSP in markets other than the energy sector. This would be contrary to normal practice, which enables the NSP to leverage its capabilities to provide services which increase competition in other markets is in the interests of consumers. Benefits are returned to customers in both industries. The regulatory regime supports such endeavour by NSPs, through the shared asset cost adjustment mechanism, and is supported by other regulatory disciplines such as the Cost Allocation Method.

The shared asset guideline was published by the AER in November 2013. It was first proposed by the AER in its 2011 Rule Change Proposal processed by the AEMC under the title 'Economic regulation of network service providers'. In its Rule Determination the AEMC recognised the benefits of asset sharing, including via the following statement:

> *The AER has been given the power to establish the shared assets cost adjustment mechanism. This will apply to assets which provide standard control services or prescribed transmission services as well as unregulated services. The shared assets cost adjustment mechanism will be designed in accordance with specific principles and guidelines. This will allow for innovation by NSPs and cost reflectivity for customers of standard control services or prescribed transmission services.* [1]

The following example of a service involving shared assets illustrates the benefits from expanded utilization of asset capability.

Box 2: Example – Scenario where Network Assets Support Telecommunications Industry

An NSP and telecommunications service provider strike a commercial agreement for the use of electricity power line towers to accommodate the Telco's mobile telephone network antennas. The participation of NSPs increases the choice available to Telco's for this purpose.

The outcome is an increase in the efficiency of Telco services and greater/new use of existing energy sector infrastructure, resulting in additional benefits to the energy networks. Benefits would be shared with energy sector customers through application of the shared asset guideline.

There is no impact on energy sector services or competitive markets. Consumers can only benefit from encouragement for NSPs to pursue such opportunities.

Source: AusNet Services

It is also common practice in Victoria for DNSPs and TNSPs to have subsidiary lines on the other's assets, for DNSPs to provide overhead service lines from another DNSPs high voltage network on the boundary of the two applicable licence areas.

[1] AEMC, Rule Determination, Economic Regulation of Network Service Providers, Page 181, 29 Nov 2012

Such access is consistent with the policy underlying the general access provision of the Competition and Consumer Act 2010 and ensures that consumers are not forced to pay for the unnecessary duplication of core assets, which naturally lend themselves to shared use.

The applicability of some ring-fencing obligations to the provision of services by NSPs in the energy networks sector that are not regulated services, or may be separately regulated services, also requires consideration. There is long standing course of conduct encouraged within the regulatory framework for provision of these services, and where NSPs operate in well-established markets. An example is the provision of new services under Victoria's contestable electricity transmission services augmentation regime. AusNet Services is the primary transmission network owner in Victoria, but augmentation of the network is overseen by AEMO, which contracts for new services.

The design of the contestability regime was founded on separation of augmentation planning and commercial interest. It included full expectation that AusNet Services would use all of its asset and system knowledge to put together a compelling proposal. The interests of consumers are best served by the incumbent NSP being able to make a competitive offer for augmentation to its network.

Another example is the sharing of resources in the management of separate regulated networks. In AusNet Services case, three regulated networks are under common management (electricity transmission, electricity distribution and gas networks). The resource sharing from this arrangement creates operational efficiencies that flow through as benefits to consumers of regulated services.

We, therefore, conclude that there is a need for the cost-benefit and consumer benefit of applying additional ring-fencing obligations to the various services provided by NSPs to be demonstrated. Many areas of service could be explicitly excluded from ring-fencing coverage, and this approach would improve confidence in alignment with the broader regulatory system, and improve certainty for all stakeholders.

Competition Principles

AusNet Services considers that broad application of the proposed set of ring-fencing obligations, precluding NSPs from participating in non-regulated services would be inconsistent with the Competition Principles Agreement[2]. This provides that any new restriction or prevention is based on evidence consistent with (a) the benefits of the restriction to the community as a whole outweigh the costs; and (b) the objectives of the legislation can only be achieved by restricting competition. These fundamental principles of competition policy were also recently confirmed by the Harper review.[3]

To be consistent with the Competition Principles Agreement the ring fencing guidelines should not impose restrictions or costs that are already adequately addressed by the existing laws of

[2] the Competition Principles Agreement of 1995 between the Commonwealth, the States and the Territories, section 5

[3] Harper et al, Competition Policy Review: Final Report, March 2015, p 97

general application in the broader regulatory system, including sections 46 and 52 of the Competition and Consumer Act 2010 (Cth).

Whilst the AER's proposed approach does not require structural separation of the NSP and the entity that would provide unregulated services, the AER does discuss this prospect in the Preliminary Positions Paper, and the set of obligations as a whole may have similar effect. In this regard we also note the deliberate removal of structural separation (or cross ownership prohibition) from the applicable legislation in Victoria in 2013. Among other reasons, those prohibitions were removed as they were no longer considered to be justified, and that, the mergers and acquisitions powers of what is now, the Competition and Consumer Act 2010 (Cth) were the appropriate mechanisms for dealing with structural concerns in the electricity sector[4].

The Harper Review also reaffirmed that competition policy is not about preventing, or restraining participants, in a market because they are large or because they have scale or scope of operations that enable them to innovate and provide benefits to consumers[5]. The Review recognized that the Competition and Consumer Act 2010 (Cth) has a range of provisions designed to address anti-competitive conduct, but reaffirmed that those provisions should only prohibit conduct that harms competition, not individual competitors and that the CCA does not, and should not, seek to restrain a competitor because it is big or because its scale or scope of operations enables it to innovate and thus provide benefits to consumers[6]. AusNet Services also supports the recommendations to strengthen the misuse of market power provisions of the CCA.

2. Principles for Ring-Fencing

AusNet Services acknowledges the categories of obligations and matters identified by the AER for the ring-fencing regime as being relevant ring-fencing mechanisms.

However, it would not be appropriate to apply these in aggregate in every circumstance. A regime that defaults to imposition of the ring-fencing obligations in respect of any unregulated or negotiated service provided by the NSP imposes risk to consumer interests and will not deliver overall economic benefit in the short term or long term. Rather, AusNet Services considers that ring-fencing obligations should be applied in a practical way, on a principles based approach.

Relevant principles include the following:

a. Focus on the best outcomes for customers

The assumption made by the AER is that imposition of the ring-fencing obligations will be in the interests of consumers. However, as discussed throughout this submission, there are strong grounds to assume otherwise. In most cases consumers are likely to be best served by competitive markets with as many participants as possible, including NSPs. As discussed in section 2, it is not only the customers of energy markets who benefit from NSP participation in

[4] Department of Infrastructure (former), issues Paper: Cross Ownership Rules for Energy Sector, January 2005, conclusion

[5] Harper et al, Competition Policy Review: Final Report, March 2015, p 285

[6] ibid

competitive markets. In this context, it is hard to see how the AER's default position to exclude NSP participation is in the best interests of consumers.

On face value the ring-fencing arrangements would lead to customers being considerably worse off. We recognise however, that the AER approach is to waive ring-fencing obligations in certain circumstances. This could enable practice encouraged by the current regulatory regime to continue. From a structural viewpoint however we consider that reliance on waivers only achieves the rational objectives of ring-fencing, i.e. accounting and functional separation (refer NEL Clause 6.17.2(a)) by back-fitting. There is risk that the starting point becomes based on an assumption that resource sharing, scale of operation, and similar characteristics that monopoly businesses hold (and which may also be held by other participants in the sector) are contrary to consumer interests, which is not the case for the majority of NSPs services.

The process through which waivers would be granted has not yet been developed, and so our comments are made in the absence of that knowledge. However we do not have confidence that waivers could provide the confidence to NSPs to pursue innovative approaches and solutions. The work involved in making and assessing waiver requests may also be significant. Preferably the ring-fencing regime would create a more certain environment for NSPs and all stakeholders. This could be done through the development of case studies, representing a spread of potential activities that an NSP may engage in, and assessing the appropriate ring-fencing approach that should apply in the interests of customers.

b. Proportionality

A key consideration is achieving the correct balance between the benefits from NSPs participating in unregulated service areas and potential harm to customers' interests.

This is not achieved with the AERs proposed approach, where all unregulated services would default to the full set of ring-fencing obligations. Typically, jurisdictional ring-fencing has focused on separation of the market segments. However the AER proposal is to apply ring-fencing across subsets of network services. It is not obvious that the proposed separation at this level is in customers interests. The value of services integration discussed via examples in this submission indicates there is a need for careful consideration of imposing separation measures at this more granular level.

A preferable approach would be for ring-fencing to be applied based on analysis of the costs and benefits according to the circumstances. Services may become subject to ring-fencing as the need is evident, applying obligations that are appropriate in the circumstances. Criteria could be devised which create thresholds for imposition of obligations within the hierarchy. This would ensure restrictions are applied in instances where this is the outcome that serves the interests of customers.

Access to information is undoubtedly a key consideration in concerns about the potential use of NSP market power. However, there is a need for the ring-fencing framework to be clear as to the circumstances in which use of this information would constitute anti-competitive behaviour.

If the information is valuable in meeting network needs and driving down costs, be those needs ultimately met by traditional network service assets or assets based on products which have become economic due to technology advances, then any concern would be unfounded. The assets in both cases provide network services.

However, AusNet Services acknowledges the intent of the Rules provisions referred to by the AER, and of the AERs proposed information related obligations. AusNet Services supports the provision and use of information on a non-discriminatory basis. The markets within which information would be used by NSPs is an area where further work could be conducted to establish proportionality guidance. In addition, particular areas of focus, such as metering data should always be dealt with in a detailed way, in the NER, rather than a less precise guideline.

Notwithstanding, with the most recent amendments to economy wide privacy legislation these instruments would be expected to provide appropriate and adequate privacy protection for consumers, and a gap analysis should be undertaken to confirm whether specific, potentially duplicative NSP ring fencing obligations would be beneficial.

c. Functionality

The approach to ring-fencing must minimise compliance costs, and be consistent with the incentive based regulatory framework.

There would be high cost incurred in establishing ring fenced operation to satisfy the intent of the obligations. Combined with loss of scale and synergy through separation this could dissuade businesses from continuing to offer the services, reducing market participation. For many services this would not be in the interest of consumers, and where in many cases the market may be dominated by participants applying significant scale and synergy.

Having regard to the three principles outlined above, an alternative and appropriate approach to ring-fencing would be for the obligations to form a 'menu of obligations', and for obligations to be assigned as appropriate to the service areas according to assessment against these.

3. Consideration of New Technologies

The development of the ring-fencing guidelines is occurring at a time when the energy sector is in the midst of a phase of transformation. New technologies are providing NSPs new opportunities to enhance network services, and new ways to promote non-network alternatives. The scope of future services, and the participants in the markets that will provide them, cannot yet be entirely foreseen. In these markets the NSP may act as the market maker (e.g. platform for new generation dynamic energy services). It would be premature to seek to constrain the evolution of the most effective and efficient arrangements, via ring-fencing prohibitions.

The incentive based regulatory framework provides an integrated suite of incentives for NSPs to make effective and efficient investments, including the Capital Expenditure Incentive Guideline. These also include choices between capital investment and operational expenditure (i.e. 3rd party service acquisition), and disciplines such as the publication of Annual Planning Reports, publication of a Demand Side Strategy, and application of the Regulatory Investment Test, which facilitate the opportunity for 3rd party participation.

Through economic assessment of alternatives AusNet Services has deployed a mix of internal and external solutions, including acquisition of network support services from 3rd parties (e.g. generation at Traralgon, load curtailment contracts, and customer embedded generation). Solutions internal to AusNet Services have also included a mixture of operational expenditure (e.g. tariff solutions, and staggering off-peak hot water heating times) and capital investment solutions (e.g. mobile generator sets).

Critically, the ring-fencing framework needs to be technology neutral. It is fundamental that the framework should not discriminate amongst the technologies and sourcing arrangements that NSPs apply in meeting their network needs. This would ensure that the guidelines are consistent with the NER.

The integration of storage into the electricity system is one of the new technology products of particular interest. In the AEMC report on the integration of energy storage, there is much discussion on separation of regulated and competitive services. However the idea that the network can access storage capability for network support purposes is more complex than envisaged in the paper. Storage solutions are only valuable to networks if it can be assured that the battery is able to provide the service when required by the network. If the battery primary function is for energy trading purposes then the battery may be already discharged when required for network support purposes. An NSPs primary goal in establishing a storage asset would be to optimise the network service.

This is consistent with the views expressed by the AEMC[7], that:

1) network businesses should use energy storage where it substitutes for traditional network, where it is efficient to do so, so long as it does not significantly displace competitive energy services; and

2) it is appropriate for storage to be financed from regulated expenditure to the extent that it is providing network services.

At the same time the AEMC said that some additional uses of batteries, for example, for energy trading is not necessarily to be discouraged, provided it was with a structurally separate or ring fenced entity and such models as the auctioning of energy trading rights or the transfer of those benefits to a retailer are attractive models[8]. AusNet Services notes that energy trading is a service area subject to ring-fencing arrangements.

More broadly AusNet Services believes the most efficient outcomes will be achieved through the retaining flexibility in the way new products and technologies integrate into services through the application, and if necessary, refinement of existing regulatory mechanisms.

[7] AEMC, Final Report: Integration Of Energy Storage (Regulatory Implications), 3 December 2015, p 21
[8] ibid

An illustration on how new technology based products may be deployed to satisfy network needs is provided in Box 3 below.

Box 3: Battery deployment scenario to mitigate network constraint

An NSP identifies an impending localised network constraint. It identifies this constraint in its Annual Planning Report (APR), and with it the estimated cost to remove the constraint service specification and minimum service specification. The cost on which the NSP solution is based could include new technology based products. Such use of new technology does not impute entrepreneurial risk into the investment decision, by the NSP.

The NSP has published a Demand Side Engagement Strategy, in accordance with the National Electricity Rules. This enables 3rd party service providers to respond to the opportunity presented in the APR, by approaching the NSP. The NSP also maintains a register of suitable interested service providers and has informed these parties of the release of the APR. A Request for Proposal framework thereby exists.

The NSP is then able to select the most efficient and effective solution. This could be chosen from among the following deployment options:

(a) a capital investment by the NSP in traditional network assets;

(b) a network support service agreement with a 3rd party for provision of services (e.g. generation, storage, demand reduction aggregation);

(c) an operational solution between the NSP and end customers, such as offering a critical peak rebate);

(d) a capital investment by the NSP which includes new technology based products (e.g. storage)

(e) ….

If option (a) or option (d) is selected as the most efficient, then there is the opportunity over time for the underlying assets to derive other forms of revenue, reducing costs for consumers funding the investment and delivering greater benefit to society. In the case of (d) there is the potential for parties to exploit capability that is out of the scope of supporting the network, to the extent that this could not compromise the network support capability specification. Again, this can reduce costs for regulated customers.

Source: AusNet Services

The scenario above demonstrates that in the provision of network services via new technologies is not in itself justification for altering the process by which efficient solutions are identified and implemented.

4. Services Requiring Up-front Consideration

Greater confidence in the ring-fencing regime would be provided if coverage was clearly stated, through ring-fencing exclusions. This would not release the NSP from maintaining reporting requirements in accordance with the National Electricity Rules, and these obligations would be determined to be the appropriate level of control for these services.

In this section we discuss two service areas where we consider up-front exclusion from coverage by ring-fencing should be considered.

a. Victorian AMI Metering

The Victorian mass market metering has been the subject of a government mandated roll out, and accordingly AMI meter services are currently provided exclusively by the network businesses, across the whole small customer base. Significant cost has been incurred in establishing this infrastructure, and the mandated arrangement provides significant benefit for Victorians.

It is not yet clear how the Victorian government will implement the national metering framework due to commence in December 2017, which is designed to implement a retailer led roll out of smart meters in other states, but as a default is applicable to Victoria's meter fleet as well. The market would be able to replace NSP meters, and once a need for replacement of a meter occurs the customer's retailer assumes responsibility for engaging a metering provider to provide the metering services.

NSPs are able to offer a meter replacement service for the customers in their network. This would necessarily be as a contestable service, as the responsibility transfers to the retailer. However, the retailer should have the opportunity to engage the NSP, to provide a metering service that is fully integrated with the NSPs metering, and with the accompanying scale efficiency, if the retailer so desires.

In this context, considerations for regional customers need to be assessed. Urban customer metering is likely to be much more attractive to new metering service providers, due to lower installation costs and maintenance costs. The metering service impact for regional areas should be an important consideration particularly if there isn't a market for metering services in remote rural areas.

For the Victorian circumstances it would appear to be contrary to customer interests for the value invested in metering to be eroded through the imposition of the more onerous ring-fencing obligations. There is a clear need for cost benefit analysis to be conducted to demonstrate value in ring-fencing the services as they migrate to a contestable framework.

b. Contestable network services

The example of Victorian transmission augmentation is discussed in Section 1. More broadly, the market for contestable, unregulated, transmission services throughout the NEM is already competitive and is made up of various TNSPs from a number of States. The interests of consumers are served by competition having been achieved between participants that all have the requisite technical capability and financial resources to fund, and provide, safe and reliable infrastructure. AusNet Services does not believe there is a reason, or evidence, to support any additional ring fencing of TNSPs in such markets, beyond the current ACCC guidelines for TNSPs[9].

Similarly, if opportunities developed for a market for contestable distribution services, AusNet Services believes the interests of consumers would be best served by permitting DNSPs to freely compete for those services. There are adequate measures in place regarding access to connection services up or downstream to ensure an incumbent is not advantaged in such a

[9] ACCC, Statement of Principles for the Regulation of Transmission Revenues: Transmission Ring-Fencing Guidelines, 15 August 2002

process. AusNet Services also believes that the obligations previously developed in ACCC ring fencing guidelines for TNSPs would address any potential for an incumbent DNSP to discourage entrants into a the market or particular opportunities.

5. Conclusions

To be consistent with the NEO the ring-fencing guideline should focus more clearly on customer outcomes than indicated by the Preliminary Positions Paper, and be based on the principles of proportionality and functionality. The guideline would be more flexible in assigning obligations in respect of areas of service, and many service areas would be excluded from coverage, providing consistency with the broader regulatory framework and greater certainty to stakeholders.

More particularly, AusNet Services is supportive of a ring-fencing approach which:

a) is consistent with the NEO and the Competition Principles Agreement;

b) recognises the existing legal frameworks of the energy sector, and the difference in those frameworks in certain States;

c) does not create additional, unnecessary costs or inefficiencies to the detriment of consumers, particularly where the objective of ring fencing is already, or capable of being achieved, through regulatory instruments or powers that exist;

d) does not confuse the advantages of scale and scope that may be obtained by a NSP in providing services with reducing competition (which prohibiting NSPs from services provision will do) and being contrary to the interests of customers;

e) takes into account existing and potential market dynamics and participants;

f) does not unnecessarily dampen innovation by NSPs, which would provide benefit to all consumers; and

g) Information required for the provision of competitive services is available and used on a non-discriminatory basis.

6. Response to AER Questions

AER Question	AusNet Services Response
Question 1: What aspects of current jurisdictional ring-fencing arrangements have or have not worked well?	Ring-fencing guidelines in jurisdictions largely focus on extent to which an NSP carries out vertically integrated activity. The ACCC transmission ring-fencing guidelines are an example and those restrictions appear to be a preferable starting point for NSP ring-fencing than the QCA guideline. Whilst there is clearly a blurring of roles going forward, it is inappropriate for ring-fencing arrangements to presuppose the way the industry should develop.
Question 2: Do you consider these objectives discussed in section 2.1 adequately reflect the harm ring-fencing is seeking to avoid and the benefits of an even playing field?	The objectives are appropriate, however there are other important considerations and achieving these objectives must also be consistent with these, including: • Ensuring best outcomes for customers (achieving the National Electricity Objective); • Ensuring consistency with the incentive framework for NSPs and supporting innovation by NSPs.
Question 3: Do you agree with the service classification approach to ring-fencing which is discussed in section 3.3? Is there a better alternative?	The service classification approach proposed by the AER would limit the NSP to being a regulated services provider. This is not consistent with the objectives for ring-fencing. The NSP should have incentives to make the most use of its capabilities, and this will be to the benefit of consumers. There is risk that service classification will separate sub groups of network services in a way that is inappropriate. A preferable alternative is the use of a 'menu of obligations' approach. This would facilitate a proportionate imposition of obligations relevant to specific circumstances.
Question 4: Does the proposed approach to ring-fencing adequately deal with the prospects for development of the contestable market for DER?	We do not think the AER approach adequately covers this area. There is likely to be significant use of DER in providing network services. This should not be treated as separate from regulated network services. There will be circumstances, potentially the predominating circumstance, where DER will be included in network services. It is not clear that other uses of DER will be sufficiently complementary that 3rd party service providers will be able to build proposals that satisfy the

AER Question	AusNet Services Response
	needs of the network. There is risk of the incentive focus of the networks sector regulatory regime being risked and presupposing the markets that will arise and how they should develop. The approach presumes that all such markets are certain to develop deep and vigorous competition if NSPs are excluded. The only certain beneficiaries of such an approach are non-NSP participants. The impact on consumers is likely to be detrimental in many instances.
Question 5: Are there other ring-fencing obligations we should impose on NSPs that provide services into contestable markets?	Those obligations that are identified should be considered a 'menu of obligations', rather than being applied in totality. Other measures included in the NER and broader regulatory system are relevant obligations and these need to be taken into account when considering proportionality.
Question 6: What costs would be incurred in meeting these obligations?	The most significant costs are the ultimate costs to consumers, of constraining the development of the most efficient solutions and corporate structures, ultimately there is a risk of reducing market competitiveness and increasing the cost of regulated services
Question 7: Should assets sharing be restricted between regulated services and contestable service provision?	There appears to be no justification for this. The disciplines in the Rules, which should be considered part of the ring-fencing regime, provide mechanisms for the cost allocation between services to be recognised and for the benefits to be shared with customers.
Question 8: Do the factors set out above reflect the issues we should consider in deciding whether to grant a ring-fencing waiver?	Relying on waiver is not the most appropriate approach as it assumes the need for onerous obligations as the default. It is likely that the reverse is the case, and that there would be very few services that in fact warrant a number of the obligations being imposed. The factors identified by the AER for consideration in assessing whether to grant a waiver are amongst those that should be considered, however we suggest that they should apply to consideration of coverage of a service, rather than for waiver.
Question 9: In which circumstances should the customers of ring-fenced	The Preliminary Positions Paper suggests that compliance costs would not be significant if the NSP does not engage in other services. This is clear, however it also true that

AER Question	AusNet Services Response
services and not customers of the DNSP's services in general pay the additional costs of complying with ring-fencing obligations?	customers will pay for the impact of reduced energy services efficiency through the NSP adopting that form of compliance. This could be a high cost. In addition, it is wholly inconsistent with the broader objective of competition policy as discussed earlier in this submission.
Question 10: How else could the AER minimise the administrative cost of ring-fencing while maintaining the integrity of its approach?	The AER approach should have regard to the mechanisms already in regulatory framework. Confidence, certainty, proportionate regulation and cost minimization will result. More proportionate approaches are also provided in guidelines such as Guideline 17 in Victoria and the ACCC's TNSP Guideline.
Question 11: Is it reasonable for the AER to consider these transitional arrangements to the new ring-fencing guideline?	Transitional arrangements would be essential. There is also a need for further consideration of pre-existing services that may become subject to obligations. It is unclear whether a waiver provides clarity. In our view the regulatory and service arrangements pertaining to pre-existing services will remain appropriate in the future and these service areas should be excluded from coverage, save for those mechanisms in the regulatory framework to which provision of the services are currently subject. Otherwise there would be significant uncertainty for NSPs and the customers receiving these services.
Question 12: How can we ensure ring-fencing compliance is robust and effective without imposing excessive costs that may ultimately be borne by consumers?	A robust and effective ring-fencing regime could be achieved by adopting a principles based approach. Relevant principles would include: • Best outcomes for customers; • Proportionality; and • Functionality.