



570 George Street  
Sydney NSW 2000  
All mail to GPO Box 4009  
Sydney NSW 2001  
T +61 2 131 525  
F +61 2 9269 2830  
[www.ausgrid.com.au](http://www.ausgrid.com.au)

28 September 2012

Mr C Pattas  
General Manager  
Network Operations and Development  
Australian Energy Regulator  
GPO Box 520  
MELBOURNE VIC 3001

Dear Mr Pattas,

**AER Position Paper - Electricity Distribution Ring Fencing Guidelines Review**

Ausgrid welcomes the opportunity to provide comments on the AER's Position Paper on its review of distribution ring fencing guidelines.

Ausgrid agrees that the adoption of a National Electricity Market (NEM) wide distribution ring fencing guideline ("guideline") could address the issues with existing jurisdictional guidelines identified by the AER and most notably, would lead to greater consistency in the application and scope of distribution ring fencing across the NEM.

Before developing a national guideline or amending existing jurisdictional guidelines, Ausgrid suggests that there would be substantial benefit in the AER:

1. clearly defining the purpose of the national guideline;
2. specifying the potential for anti-competitive behaviour or unfair competitive advantage that the AER is seeking to address through ring fencing; and
3. once Step 2 (above) is completed, conducting a review of existing regulatory mechanisms to determine whether further regulation is necessary, and if so determining a form of regulation that is proportionate to the concerns identified.

Undertaking these steps will help avoid the national guideline becoming too broad in scope, duplication of existing obligations, or the imposition of onerous or restrictive obligations that are inappropriate or disproportionate to the issue being addressed. Ausgrid considers that it is important that ring fencing does not unnecessarily distort efficient market outcomes, restrict the pursuit of cost efficiencies, result in increases in network prices to customers (due to unnecessary compliance costs) or stifle innovation or competition.

Ausgrid notes that concerns raised in response to the AER's earlier Discussion Paper regarding distribution network service providers (DNSPs) participating in emerging markets for contestable services, particularly markets for energy services, appear to stem from the lack of certainty in market arrangements for these services. We also note that the Australian Energy Market Commission (AEMC) is currently undertaking a number of market reviews to address this issue such as the Power

of Choice: Stage 3 Demand Side Participation (DSP) review and the review of market arrangements for electric and natural gas vehicles. Ausgrid anticipates that at the conclusion of these reviews, uncertainty surrounding market arrangements for these services will be clarified, which may alleviate many of the concerns expressed in previous submissions.

Our attached submission seeks to outline the steps we consider the AER should take in seeking to develop a flexible national guideline and provides comments in relation to the AER's preferred position.

If you have any queries or wish to discuss this matter in further detail please contact Catherine King on (02) 9269 2881.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'PB', is located below the closing text.

Peter Birk  
Executive General Manager System Planning and Regulation

## Introduction

---

While Ausgrid supports the development of a flexible national guideline for ring fencing we believe that it is necessary for the AER to first clearly establish the precise need and appropriate focus for this regulation. This is important as it will help ensure that regulation is not imposed unnecessarily and that any new regulatory requirements are proportionate to the need being addressed.

Before developing a national ring fencing guideline, we suggest there would be benefits in the AER:

- 1) clearly identifying the purpose of the national guideline;
- 2) specifying the anti-competitive behaviour that the AER is seeking to address through ring fencing guideline; and
- 3) assessing whether there are sufficient existing regulatory mechanisms already in place or foreshadowed that will address the concerns the AER is seeking to address through the ring fencing guideline.

Although the Position Paper addresses the issues outlined in steps 1) and 2) above to some extent, we believe that further clarification is required in order to avoid the national guideline giving rise to unintended regulatory consequences.

Our submission provides our views on how the AER might in developing the guideline, strike an appropriate balance between addressing those matters that are appropriately managed through ring fencing and ensuring that the guideline remains sufficiently flexible to apply to changing market circumstances, emerging trends, jurisdictional differences and the differing circumstances of individual distribution network service providers (DNSPs).

## Establishing the need for regulation

---

### 1.1 Clarifying the purpose

We understand the AER intends to develop the national guideline to address anti-competitive behaviour arising from participation of a DNSP, or a related business, in contestable markets. Ausgrid believes that the purpose of the guideline should be clarified so that it is clear that ring fencing is limited to circumstances where a DNSP is participating in both a competitive market as well as the monopoly market, and is able to use its position in the monopoly market to provide it with an *unfair advantage* over other participants in the competitive market, thereby adversely impacting competition. This clarification is important as it reflects the overarching purpose of ring fencing.

Ausgrid is concerned that without further clarification, the scope of the national guideline may be applied too broadly and may inadvertently capture activities it is not intended to cover. This could potentially impose unnecessary costly obligations on network businesses and adversely affect industry innovation. Ausgrid is particularly concerned that the guideline might constrain or preclude DNSPs from undertaking activities aimed at flexibly managing their network in the most cost efficient way or from engaging in demand side participation aimed at managing peak demand to alleviate network constraints. As these activities are not undertaken for the purposes of participating in competitive markets to earn unregulated revenue, it would be inappropriate if the guideline applied.

The Australian Energy Market Commission (AEMC) has made a similar point in its draft report "Power of Choice – Stage 3 Demand Side Participation (DSP) Review". In its draft report the AEMC notes that significant benefits from demand side participation may not be realised if ring fencing arrangements restrict the ability of DNSPs to provide generation services.<sup>1</sup> The

---

<sup>1</sup> See AEMC, Draft Report : Power of choice – giving consumers options in the way they use electricity, pp 142-144.



AEMC noted that DNSP owned distributed generation assets which are primarily used to provide regulated network support services could also be used to provide power during wholesale market peaks. This has the potential to reduce the cost of supply and minimise price increases for consumers in the long term by deferring the need for capital investment. Ring fencing requirements that are inconsistent with this outcome are contrary to the National Electricity Objective in this respect.

### **1.2 Identifying the anti-competitive behaviour the guideline seeks to address**

It is important that the AER first establish the need for regulation. As regulation by its nature is intrusive and increases the cost of providing services,<sup>2</sup> it should only be imposed when it is required to address a market failure. In the context of ring fencing, the potential for market failure arises where there is an opportunity for a DNSP to use its monopoly position to gain an unfair advantage over other participants in a competitive market. This may be through:

- cross subsidisation, involving the monopoly business paying for or subsidising resources that are used by the competitive business, making it more difficult for independent participants to compete in the market; or
- preferential treatment or information sharing between the monopoly network business and its associated contestable business.

When a DNSP operates a contestable business, it is arguable that there are incentives for it to engage in anti-competitive behaviour to maximise its revenue. Ausgrid recognises that this behaviour is contrary to the interests of consumers and supports targeting behaviour which may result in:

- cross subsidies or other discriminatory interactions between the contestable and non-contestable activities of the DNSP;
- the DNSP gaining an unfair advantage by using information acquired from a regulated activity for the benefit of a contestable activity; and
- the creation of an uneven playing field that may deter potential market participants.

### **1.3. Assessing the adequacy of existing and foreshadowed mechanisms for addressing anti-competitive behaviour**

Ausgrid notes that a number of stakeholders have raised concerns regarding DNSP participation in emerging markets for energy services, particularly services and technologies aimed at facilitating DSP. We believe that these concerns largely stem from the current uncertainty surrounding market arrangements for these services. For example, we note that the Energy Retailers Association of Australia (ERAA) has expressed concerns regarding DNSPs being able to offer contestable services without an appropriate regulatory framework setting out the roles or principles underpinning competition within these markets as well as rules governing how market participants are to interact with customers.<sup>3</sup>

Ausgrid notes that there are a number of significant market reforms currently underway which are aimed at clarifying market arrangements for these emerging markets. These include:

- Australian Energy Market Commission's (AEMC's) Power of Choice: Demand Side Participation (DSP) – Stage 3 Review ("Power of Choice Review")
- AEMC's Review of Market Arrangements for Electric and Natural Gas Vehicles;
- Department of Resources, Energy and Tourism (DRET) study into the implementation of an electricity information hub; and
- Standing Council of Energy Resources – smart meter work program.

<sup>2</sup> Regulation increases the cost of providing services as it imposes establishment costs, administrative and compliance costs and creates inefficiencies and losses of economies of scale.

<sup>3</sup> Energy Retailer Association of Australia (ERAA), Electricity Distribution Ring-Fencing Guideline Review, 24 February 2012, p 3-4.



### **1.3.1. Overview of foreshadowed mechanisms**

This section provides an overview of foreshadowed initiatives aimed at ensuring a level playing field for market participants in markets for energy related services. In Ausgrid's view, if these mechanisms are effective, there may not be a need for a national ring fencing guideline.

#### *Power of Choice Review*

The AEMC's Power of Choice Review is aimed at identifying market and regulatory arrangements needed to facilitate the efficient investment in, operation and use of DSP in the NEM.

We note that the ERAA appears concerned that DNSPs may have exclusive control of the use of advanced metering infrastructure (AMI) and smart meter infrastructure services (SMIS), placing them in a position to collect extensive data about customer usage which will enable the DNSP to target customers in a way which is not possible for others who do not have access to the same full data set.<sup>4</sup> The concern is that there may be opportunities within these markets for DNSPs to entrench competitive advantages arising from access to information and other resources of the regulated DNSP.

The AEMC's Power of Choice draft report makes a number of recommendations aimed at clarifying the role of parties who engage with customers to provide DSP energy services, access to electricity consumption information and metering arrangements.<sup>5</sup> The draft report seeks to address these issues by considering a new framework for interval and smart metering and associated services. The draft report proposes a number of clarifications to the National Energy Customer Framework (NECF) and National Electricity Rules (NER) regarding access to customer consumption and metering data. Ausgrid's view is that there is sufficient focus on the issue of participation by DNSPs in these emerging energy services markets to provide comfort to retailers that the issue is being addressed at a policy level.

Ausgrid considers that provided the appropriate regulatory mechanisms are in place to ensure a level playing field, DNSPs should be able to participate in DSP markets without being disadvantaged by a layer of regulation that does not apply to other participants in the market. In our view, to impose additional regulation where there is no regulatory need will artificially restrict the level of competition in the market, hinder consumer choice and stifle innovation. Ausgrid urges the AER to carefully distinguish between concerns regarding unfair competition and efforts to limit competition in the market. Ring fencing guidelines are only required to address the former and should not be capable of extending to restrict competition and participation in the market by DNSPs to the detriment of consumer choice.

If the AER forms a view that the regulatory and market mechanisms proposed by the AEMC through industry consultation are insufficient, and that further regulation is still required, it may find that a flexible, high level approach towards the operation of the national guideline (supplementing any solutions proposed by the AEMC) is more appropriate than a prescriptive approach.

---

<sup>4</sup> ERAA, Electricity Distribution Ring-Fencing Guideline Review, 24 February 2012, p 4.

<sup>5</sup> See Summary of key recommendations contained in the AEMC's Draft Report, 'Power of choice – giving consumers options in the way they use electricity,' 6 September 2012, ppi –vi.



### *Energy Information Hub*

The Australian Government, as part of its 2011 Clean Energy Policy is undertaking work to implement an energy information hub.<sup>6</sup> It is intended that the energy information hub will provide individual consumers (or their authorised agents) with convenient and timely access to their individual electricity consumption profiles using data from smart and interval meters. The energy information hub would provide a platform for enabling open access arrangements to customer information.

Ausgrid supports the need for open access to information amongst participants in markets for energy services, provided that this is done in accordance with confidentiality, security and privacy arrangements under the NEL, NECF, and other Australian and jurisdictional regulatory instruments. We believe that the implementation of an energy information hub coupled with some of the reforms contemplated under the AEMC's Power of Choice Review could assist in facilitating a level playing field for market participants in energy services markets.

### *SCER Smart Meter*

The SCER smart meter program consumer protection and safety program is currently considering the circumstances under which NECF should apply and the need for any additional arrangements covering services enabled by smart meters. We note that this should address retailers' concerns regarding customer protection. This work should help in developing a clear framework governing how market participants interact with customers by setting out market participants' roles and responsibilities in relation to smart metering.

### **1.3.2. Overview of existing mechanisms**

In addition to the work being undertaken in various forums at a policy level outlined above, there are a range of regulatory and other arrangements currently in place in NSW which achieve ring fencing objectives. These include:

- Ausgrid's ministerially imposed licence conditions, which require separation of accounting and business records;<sup>7</sup>
- Contestable connection services arrangements. The contestable works code of practice and Accredited Service Provider Scheme apply to contestable connections work undertaken by Accredited Service Providers;
- National Energy Customer Framework (NECF);
- Privacy Act 1988 (Cth); and
- Competition and Consumer Act 2010 (Cth) (CCA) – sections 46 and 50.

The NECF establishes the energy specific customer obligations and arrangements for regulating the sale and supply of electricity and gas to consumers. It covers a range of matters, including contractual relationships between retailers and consumers and associated rights and obligations, consumer protection measures, including in relation to marketing and informed consent, and security and privacy provisions. There are also provisions that relate to the relationship between distribution businesses and consumers, specifically for customer connection services.

---

<sup>6</sup> The Department of Resources, Energy and Tourism (DRET) engaged Sapere Research Group to consider possible versions of an energy information hub and to assess any barrier created by the NER or market behaviour that could impede access to consumption information.

<sup>7</sup> Schedule Listing of Ministerially Imposed Licence Conditions for Distributor Network Service Provider, clause 4.3 and 4.4. **Clause 4.3** The Licence Holder must keep separate accounting and business records for its distribution system operation functions. **Clause 4.4** The Licence Holder may use any resource for both its distribution system operation affairs and any of its other affairs, provided that resource is allocated and costed between those affairs in the same way as it would be allocated and costed between separate unrelated legal entities sharing that resource on a commercial arms length basis.



Ausgrid notes that stakeholders have raised concerns that there may be a deficiency with the application of the NECF, as it does not apply to DNSPs competing in energy services markets. Stakeholders have argued that this places DNSPs at an unfair advantage as they are not subject to the same level of regulation (under the NECF) as other market participants. As noted above, the Power of Choice Review and SCER Smart Meter Program are aimed at addressing this issue, as well as testing the adequacy of current arrangements for accommodating emerging industry trends. Ausgrid's view is that this issue is more appropriately addressed via the clarification of roles, responsibilities and market arrangements under the NER and NECF, rather than by the ring fencing guideline. In our view, the role of ring fencing should be to provide guiding principles for how DNSPs should behave in contestable markets. It is the role of the regulatory framework for these markets to set out the detailed rules for participation.

While it is true that DNSPs are not subject to the same provisions of the NECF as retailers, they are still subject to the overarching requirements governing competition contained in the Competition and Consumer Act 2010 (*Cth*) (CCA).<sup>8</sup> Section 46 contains a general prohibition on misuse of market power. Determining whether a corporation has misused its market power in contravention of section 46 involves a two stage process. First, it is necessary to identify the relevant markets in which the corporation operates. Once the relevant markets have been identified, it is then necessary to assess the degree of power the corporation has in those markets.<sup>9</sup> It is important to note that the CCA does not prohibit a corporation from having substantial market power. Rather, section 46 only prohibits a corporation which has such power from taking advantage of that power for a proscribed anti-competitive purpose.

Ausgrid is not aware of the extent to which any assessment has been made of the market power of DNSPs in the market for ancillary energy services; however, to the extent that such market power exists, the CCA and its strong enforcement regime would provide consistent protections against DNSPs or any other market participants misusing their position to gain an unfair advantage over other competitors.

## **Determining appropriate ring fencing obligations**

---

Ausgrid strongly believes that answering the question as to whether regulation is required and to what extent, will enable the AER to develop a national guideline which is appropriate in the circumstances. As noted in section 1.3 of our submission, there are a number of mechanisms (both existing and foreshadowed) which address the potential for anti-competitive behaviour in emerging markets for contestable energy services.

In the event that the AER concludes that ring fencing is still necessary to achieve a level playing field, we have provided commentary on the cost and benefits of ring fencing, as well as specific comments in relation to the AER's preferred position.

### **2.1 Consideration of the costs and benefits of ring fencing**

In determining whether to impose an obligation or the level of prescription required, Ausgrid considers that it is essential that the AER takes into account potential up front costs and disruption to the business, as well as the ongoing intrusiveness of compliance requirements in light of the identified need. We note that the typical ring fencing costs include<sup>10</sup>:

- Initial set-up costs – for example, costs associated with business reorganisation, including process and system changes; and
- Ongoing operational costs – including compliance and monitoring costs, and losses of economies of scale.

---

<sup>8</sup> Refer to sections 46 and 50.

<sup>9</sup> This, in turn, requires a consideration of the extent to which the corporation's pricing and other decisions are constrained by its competitors, suppliers and customers.

<sup>10</sup> IPART, *Ring Fencing of New South Wales Electricity Distribution Network Service Providers*, Discussion Paper and Draft Ring Fencing Guidelines, p 4.



In developing a national guideline, it is vital that the AER has regard to the benefits it considers ring fencing provides and carefully weighs these against the possibility of ring fencing adversely affecting consumers by reducing existing economic efficiencies and imposing additional operating costs on network businesses, which can ultimately flow through to consumer prices.

## **2.2 Comments in response to the AER's preferred position**

### **2.2.1 Approach towards developing the national guideline**

Ausgrid supports the AER's preference to adopt a flexible approach towards ring fencing. Our submission has sought to demonstrate to the AER the range of existing and foreshadowed mechanisms that address the issue of DNSPs unfairly entrenching competitive advantages in emerging markets for energy services. Given the mechanisms already (or soon to be) in place to ensure a level playing field and prevent anti-competitive behaviour, we do not believe that a prescriptive approach which imposes stringent ring fencing obligations is necessary.

However, we note that a key challenge in developing the national guideline will be striking an appropriate balance between :

- providing sufficient flexibility to accommodate market changes, jurisdictional differences and DNSP circumstances;
- providing sufficient clarity to enable DNSPs to comply with the guideline in a manner that achieves the AER's objectives;
- meeting AER objectives and customer price outcomes ( i.e. minimising unnecessary compliance costs and maintaining existing economic efficiencies).

In our view, clearly defining the purpose of the guideline, as well as identifying the potential anti-competitive behaviour or unfair competitive advantage the guideline seeks to address, will enable the AER to strike an appropriate balance between these objectives, as well as ensuring that the resulting obligations are proportionate to the regulatory need. If the AER does not follow this approach, the risk is that the guideline may impose overly stringent requirements which may give rise to unintended consequences. For example, the prescriptive nature of Queensland's current guidelines prevents DNSPs from carrying on any business related to producing, purchasing or selling electricity, even if the DNSP is seeking to carry out this activity for the purpose of supporting its network or to assist it in meeting licence conditions.

Ausgrid suggests that in developing the national guideline, the AER considers the approach taken by the Independent Pricing and Regulatory Tribunal (IPART) in developing NSW's ring fencing guidelines outlined below.<sup>11</sup> IPART:

- provided a high level description of the purpose of ring fencing;
- discussed the need for ring fencing in light of existing mechanisms;
- developed a set of high level principles aimed at ensuring the development of a fair guideline<sup>12</sup>;
- outlined its proposed ring fencing framework;
- outlined its proposed specific guidelines and their rationale; and
- requested stakeholder feedback from interested parties.

We believe that this approach was instrumental in ensuring that the ring fencing obligations in NSW were proportionate to the regulatory need. The success of this approach in facilitating

---

<sup>11</sup> See IPART, *Ring Fencing of New South Wales Electricity Distribution Network Service Providers*, Discussion Paper and Draft Ring Fencing Guidelines, September 2000.

<sup>12</sup> See IPART, *Ring Fencing of New South Wales Electricity Distribution Network Service Providers*, Discussion Paper and Draft Ring Fencing Guidelines, September 2000, p 9.



competition is evidenced by the significant amount of contestable connections carried out in NSW.<sup>13</sup>

It is important that the AER decides on a set of rules that safeguards competition and protects monopoly customers, while not unduly restricting the ability of DNSPs to pursue their commercial goals. Kenneth Costello, an American economist, describes this situation, and the most favourable outcome, in his paper, *Fair Trading in Retail Electricity Markets*:

*Efficient competition requires that all incumbent and prospective firms be given equal opportunities to compete for customers. Equal opportunities have different connotations among the different interest groups, as well as among economists. For example, a utility may interpret standard-of-conduct rules as overly restrictive, placing its affiliate at a disadvantage, while non-affiliates may regard these rules as necessary to avoid what they perceive as inherent favouritism towards the utility affiliate... In the context of competitive sports, fair rules are supposed to show no partiality toward any team or individual. They should result in outcomes that depend solely on the skills of the participants – that is, the best should always win. In the marketplace, fair rules should produce winners on the basis of their ability to satisfy customers, nothing else. This means that new entrants should have the same opportunities as incumbents to succeed while, at the same time, incumbents are not unduly restricted in their market activities.<sup>14</sup>*

### **2.2.2 Clarifications and suggestions on the AER's preferred position**

The AER's preference is to develop a national guideline which imposes the following obligations:

- legal separation
- accounting separation
- allocation of costs
- limitations on the flow of information
- physical, staffing and functional separation
- non-discrimination
- waiver ring fencing obligations
- compliance and reporting

We note that the AER's preference towards imposing the above obligations may be based on the criteria in clause 6.17.2(b) of the NEL, which sets out a list of obligations that may be included in ring fencing guidelines. Ausgrid is concerned that the AER may have misinterpreted the meaning of clause 6.17.2(b) in developing the above criteria and in reaching its preferred position. Clause 6.17.2(b) does not require the AER to impose all of the listed obligations, nor is the AER limited to those obligations in developing its guideline.

Before imposing any obligations the AER needs to establish that regulation is necessary. If the AER determines that regulation is necessary, then it must then determine the appropriate form of regulation and ensure that it is proportionate to the regulatory need being addressed. In particular, it is important that the AER have regard to the costs imposed by the regulation and ensure that the regulation will deliver benefits to the market in excess of the costs. In assessing whether regulation is necessary, it is also vital that the AER takes into account whether mechanisms are already in place to address the issue.

Ausgrid's view is that adopting a prescriptive approach towards the operation of the national guideline will make it difficult for the guideline to flexibly address the variety of circumstances

---

<sup>13</sup> For example, approximately, 20,000 connections or changes to services took place in 2009-10, most of which were carried out by third party ASPs.

<sup>14</sup> Costello, Kenneth (1998), *Fair trading in Retail Electricity Markets*, (National Regulatory Research Institute, June 1998), p.3.

in which it would apply, including jurisdictional differences and the differing circumstances of individual DNSPs. Such an approach also presupposes that particular ring fencing obligations are always appropriate to address a particular market concern. Given the speed of developments in energy related technologies, any attempt to define prescriptively when, and under what conditions it is appropriate for DNSPs to participate in emerging markets would risk becoming quickly obsolete.

Ausgrid believes that if a blanket approach to ring fencing were to be adopted, it would need to incorporate appropriate exemptions that recognise state based requirements. We are concerned that without an exemption, the national guideline may risk duplicating existing regulatory obligations or imposing an unnecessary layer of regulation in some jurisdictions. Waiver provisions, although useful in the context of accommodating individual DNSP's circumstances, are not appropriate for addressing the issue of legislative differences between jurisdictions. This is because each DNSP operating in the jurisdiction would be required to apply for the same waiver, which in turn would require the AER to assess the validity of each application, leading to a significant administrative burden. We consider that an exemption clause would be a more efficient means of addressing this issue.

## **Conclusion**

---

Ausgrid supports the AER's preferred position of developing a national guideline that takes a flexible approach to ring fencing.

Ausgrid's submission has sought to highlight the importance of first establishing the need for regulation in order to avoid unnecessarily distorting efficient market outcomes, restricting the pursuit of cost efficiencies, stifling innovation or competition and duplicating existing obligations. We believe that clearly establishing the purpose and objectives for ring fencing and assessing this against existing and foreshadowed regulatory and market mechanisms, will enable the AER to establish ring fencing requirements which are proportionate to the identified need.

Our submission has sought to assist the AER by providing the AER with our views on:

- the appropriate purpose of the national guideline;
- the potential anti-competitive behaviour appropriate for the national guideline to address;
- the adequacy of existing and foreshadowed mechanisms in NSW for addressing anti-competitive behaviour; and
- the appropriate form of ring fencing.

If the AER determines that ring fencing is necessary, Ausgrid's view is that the development of a national guideline would address the issues identified by the AER in its Position Paper<sup>15</sup> and ensure greater consistency in the application of ring fencing obligations across the NEM. We have also suggested that there may be a need for appropriate exemption provisions, in addition to proposed waiver provisions, in order for the national guideline to have sufficient flexibility to address jurisdictional differences.

---

<sup>15</sup> See AER, Position Paper- Electricity Ring-Fencing Guidelines, September 2012, p. 9.