

Energex

Submission on AER's Draft
Ring-fencing Guideline

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positive energy

Table of Contents

1	EXECUTIVE SUMMARY	1
2	RELATIONSHIP WITH OTHER REGULATORY INSTRUMENTS	3
3	OBLIGATIONS TO ADDRESS CROSS-SUBSIDIES	5
	3.1 Legal Separation – Ambiguity	5
	3.2 Legal Separation – Disproportionality	6
	3.2.1 Waivers.....	7
	3.2.2 Treatment of New Services	8
	3.2.3 Materiality Threshold	8
	3.3 Establish and maintain accounts	9
	3.4 Cost allocation and attribution.....	9
4	OBLIGATIONS TO ADDRESS NON-DISCRIMINATION	10
	4.1 General obligations.....	10
	4.2 Functional separation	10
	4.2.1 Physical Separation.....	10
	4.2.2 Staff Sharing.....	11
	4.3 Information access and disclosure.....	12
5	WAIVERS.....	14
6	COMPLIANCE AND ENFORCEMENT.....	16
7	TRANSITIONAL ARRANGEMENTS.....	17
	APPENDIX 1: ALTERNATIVE DRAFTING	A-1

1 Executive Summary

Energex Limited (Energex) welcomes the opportunity to provide a submission in response to the Australian Energy Regulator's (AER) Draft Ring-fencing Guideline for Electricity Distribution (the Draft Guideline). Energex is fully supportive of a national ring-fencing guideline and believes that, if carefully crafted, the guidelines will be integral to ensuring the distribution services provided by Distribution Network Service Providers (DNSPs) are delivered efficiently in accordance with the National Electricity Objective (NEO) and that competition is allowed to develop where feasible elsewhere in the electricity supply chain.

Energex supports increased contestability in markets for emerging energy-related technologies, with the expectation that DNSPs are not excluded from participating in these markets and that the ring-fencing arrangements meet the necessity principle. Energex agrees in principle with the AER's revised ring-fencing objectives of addressing the two specific potential harms posed by DNSPs of cross-subsidisation and discrimination. The AER has indicated that they have had regard to the Council of Australian Governments (COAG) best practice regulation principles. While the COAG best practice regulation principles provide a constructive framework, Energex considers that key principles of predictability, proportionality, targeted approach and promoting confidence could be better met by refining the approach currently outlined in the Draft Guideline.

Specifically, Energex has the following key concerns regarding the Draft Guideline:

- Ambiguity around obligations and interaction with other regulatory instruments
- Disproportionality of obligations to the harm that is being addressed
- Transitional arrangements which see obligations commence too quickly.

Firstly, Energex considers the Draft Guideline has created ambiguity in its scope and uncertainty regarding its practical application. The current drafting lacks clarity around the scope of services to which the obligations apply. This will inevitably create challenges and uncertainty for compliance and result in additional compliance costs.

Secondly, Energex considers the obligations to be disproportionate to the harm the AER is seeking to address. Ring-fencing arrangements should be proportional and targeted in approach, such that more onerous ring-fencing obligations only apply where competition (market power) concerns are material. Energex considers that the proposed legal separation, functional separation and information disclosure obligations far exceed what is required to meet the AER's objective. This may result in excessive and unnecessary compliance costs with no customer benefit to be realised.

Thirdly, Energex considers that the transitional arrangements do not provide adequate timeframes to achieve compliance and will potentially drive additional costs. The Draft Guideline contemplates greater legal separation than is currently required as well as functional separation, which is a new and significant obligation. Complying with the proposed

obligations will have substantial contractual and operational implications depending on the form of the Final Guideline.

Energex has provided alternative drafting at Appendix 1 to address some of its concerns, namely to:

- provide greater clarity around the scope of services and the ring-fencing obligations to apply
- limit the legal and functional separation obligations to be more proportionate to the potential harm the AER is seeking to address
- provide a minimum 12 month transitional period for legal and functional separation obligations as well as branding obligations and a 3 month period for separate accounts/cost allocation and general non-discrimination obligations.

Given the criticality of having effective ring-fencing guidelines in place, Energex requests the AER to release an early exposure draft prior to publication of the Final Guidelines on 30 November 2016. Energex is willing to engage and discuss any issues as well as alternative drafting with the AER. The remainder of this submission presents comments aligned to the subject matter headings in the Draft Guideline.

2 Relationship with other regulatory instruments

The Draft Guideline states that it should be read in conjunction with a number of regulatory instruments including a DNSP's distribution determination, the cost allocation guideline, the Cost Allocation Method (CAM), the Shared Asset Guideline (SAG) and the regulatory information instruments served on a DNSP. However, Energex believes that the drafting does not reflect this.

Energex supports the AER's view that the Cost Allocation Guideline and a DNSP's CAM are the appropriate regulatory instruments to ensure the allocation of a DNSP's costs between its distribution services as well as its non-distribution services (Energex's CAM allocates overhead costs to unregulated services). Reporting under regulatory information instruments provides the AER with oversight and assurance that cross-subsidisation and discrimination does not occur. The interaction between the Draft Guideline and these instruments is clear and well recognised.

However the relationship between the Draft Guideline and the current distribution determination (in particular the Framework and Approach (F&A) decision) and the SAG is ambiguous and requires clarification. The current drafting does not address either the F&A decision or the SAG in the substantive obligations or the definitions.

The interaction of the Draft Guidelines with the F&A decision will also create transitional issues, partly due to the earlier, binding F&A decisions being somewhat out of step with more recent rule changes such as Power of Choice which give effect to government policy for metering contestability. A key issue, at least in the short term, is that the AER has indicated its preference for the classification of services under the F&A to largely determine the scope of services to which the ring-fencing obligations apply. However, based on current AER approved service classifications this approach probably fails to meet the intent of ring-fencing distribution services from other electricity services that are provided to end-use customers on a contestable basis.

Challenges arise when applying the Draft Guideline and the SAG to non-distribution services (classified in accordance with Energex's F&A decision) such as rental access of the distribution network for telecommunications services. Based on the Draft Guideline these non-distribution services would need to be legally and functionally separated. This appears perverse given that the SAG provides for regulated distribution assets to be used for the provision of unregulated non-distribution services with a view to improved asset utilisation and benefits to regulated customers. The benefits are realised through an adjustment to the annual revenue requirement beyond a materiality threshold. Energex considers that a DNSP should be allowed to seek to achieve economies of scope and/or scale in delivering distribution services, and that this is in the long term interests of consumers and the NEO.

Regulated customers can potentially benefit from having a proportion of the cost of Energex's regulated assets recovered from unregulated customers. Therefore, Energex requests that the Final Guideline expressly exclude its application to services provided using assets subject to the SAG.

Energex understands that the AER is preparing a classification of services guideline for publication next year. In addition, industry is aware of the upcoming Australian Energy Market Commission (AEMC) rule change proposal on contestability of energy services initiated by COAG Energy Council, the outcome of which is likely to directly impact on the application of the Final Guideline. Interactions between the Final Guideline and proposed classification of services guideline and contestability rule change will need to be very carefully considered given that they will be inextricably linked.

3 Obligations to address cross-subsidies

Energex's concerns regarding the ambiguity and disproportionality of obligations to address cross-subsidies are set out below.

3.1 Legal Separation – Ambiguity

The Draft Guideline requires the legal separation of network services that can only be provided by a DNSP, from non-network services. While Energex understands that the terminology of network services was used with a view to permitting distribution and transmission services to be performed by one legal entity, the Draft Guideline does not achieve this and creates ambiguity. This is because the meaning of network service appears narrower than the meaning of distribution service under NER.

Network services are defined in the NER as:

Transmission service or distribution service associated with conveyance, and controlling the conveyance, of electricity through the network

while *Distribution service* is defined in the NER as:

A service provided by means of, or in connection with, a distribution system.

and *Distribution system* is defined in the NER as:

A distribution network, together with the connection assets associated with the distribution network, which is connected to another transmission or distribution system.

Connection assets on their own do not constitute a distribution system.

However, the definition of network is:

The apparatus, equipment, plant and buildings used to convey, and control the conveyance of, electricity to customers (whether wholesale or retail), excluding any connection assets. In relation to a *Network Service Provider*, a network owned, operated or controlled by that *Network Service Provider*.

This excludes connection services which under the F&A decision are distribution services. The AER's F&A decision for Energex categorised *distribution services* in the following subgroups:

- network services
- connection services
- metering services
- public lighting services

-
- ancillary network services.

Applying the legal separation obligations under the Draft Guideline by retaining the use of the term network services could result in some standard control services, such as Energex's standard connection services and alternative control services having to be ring-fenced from network services. As these services are subject to revenue/price controls set by the AER, it is not clear what harm to competitive markets will be avoided by requiring legal separation of network services.

To address this ambiguity and align the drafting with the AER's intent as contemplated in the Explanatory Statement, Energex recommends the replacement of network services with distribution and transmission services as set out at Appendix 1.

3.2 Legal Separation – Disproportionality

Energex is also concerned that the obligations in the Draft Guideline requiring legal separation of some services from the DNSP are inappropriate and inconsistent with the ring-fencing intent.

The AER's approach, of which Energex is broadly supportive, is to have the DNSP's F&A decision define the scope of distribution services which are required to be ring-fenced. However, in order to achieve this, an appropriate definition of distribution services is required that aligns with the DNSP's distribution determination, rather than the NER definition on which the current Draft Guideline is based. Energex has provided alternative drafting for the definition of distribution services as set out at Appendix 1.

A secondary issue that arises with this approach is that while the service classifications under the current F&A decisions were made in accordance with the NER, neither the AER nor DNSPs considered at the time that these classifications would determine future obligations for legal separation. Based on the Draft Guideline a number of services classified as non-distribution services would need to be provided by a separate legal entity despite there being no real concerns about cross-subsidisation. As discussed in section 2, this is a function of the F&A classification of services not dovetailing effectively to the Draft Guideline at least in the short term. This in turn results in the obligations extending beyond the anti-competitive harm the AER is seeking to address noting that the CAM is in place to support appropriate cost allocation.

To address this issue, Energex considers that the services currently treated as non-distribution services in its F&A decision should for the purposes of this Guideline be considered distribution services until the next distribution determination takes effect (at which time, services will be appropriately classified through the F&A process). These services arguably meet the broad definition of distribution services in that they are provided by means of, or in connection with a distribution system and include contracting services to other network service providers such as emergency response and rental access services that are subject to the SAG. In allowing these services to be provided by a DNSP, economies of

scale and/or scope in distribution services can be achieved which is ultimately of benefit to distribution customers through the operation of the CAM and SAG.

If such transitional arrangements are not addressed, the legal separation (and thereby the functional separation) of these non-distribution services could have potential unintended consequences, for example incentivising DNSPs to no longer provide certain services because of the additional ring-fencing costs. Perversely, the withdrawal of DNSPs from some service provision might reduce the level of competition or result in a service not being offered at all.

The classification of these services will be reconsidered as part of Energex's next distribution determination and in light of any AEMC's rule change in relation to contestability of services and associated service definitions. As discussed above, Energex recommends the inclusion of provisions to treat existing services classified by the AER as non-distribution services as unclassified distribution services for the purposes of the ring-fencing guideline until the Energex's next distribution determination. At this time services can be reclassified to better align with the intent of the guideline. Energex also considers that it is essential for a consistent approach to defining distribution services to be applied across all DNSPs and jurisdictions to the extent possible noting that different market circumstances may exist and should be recognised in service classification decisions. Energex proposes alternative drafting options set out at Appendix 1, which aim to harmonise the Draft Guideline and the F&A in the short term (either through a definitional or waiver approach).

In Energex's view, the impact of this proposal on the markets for the provision of these limited services would be negligible or non-existent, noting that this Draft Guideline is to accommodate contestable, end-user (rather than incidental) non-distribution services. Any concerns regarding cross-subsidisation are more than adequately addressed through the establishment of separate accounts and cost allocation. This pragmatic approach avoids unnecessary additional administrative costs associated with legal and functional separation for no customer benefit.

3.2.1 Waivers

Given the importance of clearly defining the scope of services to which the obligations apply in terms of certainty and compliance, waivers should be available in relation to legal separation obligations at least on a transitional basis until the next distribution determination. Energex's preference is to harmonise the ring-fencing guideline with the F&A by adopting an appropriate definition of distribution services for the purposes of the Guideline that captures some of those services currently classified as non-distribution services, until the next distribution determination. However Energex also considers that waiver provisions applying to legal separation would provide an important safeguard where there is no potential for cross-subsidisation and the compliance costs outweigh the benefits to customers. Appendix 1 includes an additional waiver provisions relating to section 3.1.

3.2.2 Treatment of New Services

Energex considers that the ring-fencing guideline should allow for any new service to be considered a distribution service for the purposes of the Guideline if that new service meets the definition of a distribution service under the NER, but because the service was not contemplated during the last F&A process, is not classified in the current distribution determination. The service could be an unclassified service, in which case the only implication would be that it is classified this way in Energex's subsequent distribution determination. Alternatively, the service could be proposed as an alternative control service with a price cap proposed as part of Energex's annual pricing proposal. Energex proposes that the definition of distribution service should contemplate the provision of new services which are likely to be classified as a distribution service in the next distribution determination. Alternative drafting for the definition of distribution services which captures this issue is at Appendix 1.

3.2.3 Materiality Threshold

Energex requests that the AER give further consideration to increasing the fixed amount threshold and that any materiality threshold be based on expected costs for compliance purposes.

Section 3.1(b) exempts DNSPs from legal separation obligations in providing non-distribution services up to a total annual cost of \$500,000. The ring-fencing obligations will align directly to the AER's F&A decision. In classifying services, the AER must take into account a number of factors including the potential for development of competition in relevant markets. As a result, the classification of services in each DNSP's F&A decision may not always align due to different market circumstances.

The AER has stated that consistency across DNSPs was the basis for its proposed fixed \$500,000 dollar threshold for all DNSPs and its size reflects the likely impact on the development of contestable markets and the confidence of parties other than DNSPs operating in these markets. However, Energex considers that the high degree of uncertainty regarding the size of a potentially wide range of contestable markets comprising businesses of varying sizes from large to small invalidates such a small fixed dollar threshold.

Rather, Energex considers that the threshold needs to consider the costs imposed on the DNSP due to legal separation, which in most cases will be substantially in excess of \$500,000, particularly if asset transfers are required as part of the separation. In practice, the costs of legal separation will be 'paid for' either by the DNSP (in terms of lower profit), and/or distribution customers (if the sharing of common distribution network costs with an unregulated activity is no longer possible) and/or consumers in the unregulated service market (if prices in that market support recovery of the cost). In other words, the cost of legal separation is a real cost that should be avoided unless there are legitimate concerns about DNSP behavioural harms in specific contestable services markets. This needs to be assessed on a case by case basis.

In light of the non-trivial cost of legal separation, ideally the size of the DNSP is an appropriate threshold measure. Applying the SAG and cost passthrough materiality threshold of one percent of annual revenue requirement would result in a threshold of approximately \$12 million. Energex recognises that the AER's appetite for a threshold of this order may be very low but recommends further consideration to increasing the fixed amount threshold. In addition, any materiality threshold should be based on expected costs for compliance purposes.

3.3 Establish and maintain accounts

Energex supports obligations to establish and maintain appropriate internal accounting procedures necessary to report the extent and nature of related party transactions under section 3.2.1. However, Energex seeks to clarify the interaction of these obligations with existing regulatory reporting obligations.

For example, DNSPs are required to operate appropriate internal accounting procedures to enact the CAM and complete its regulatory accounts annually. Furthermore, related party transactions are subject to scrutiny under the Forecast Expenditure Assessment Guideline¹, with the AER stating that it will assess related party contracts and margins to ensure efficiency of expenditure incurred by a DNSP as a result of a related party transaction. Related party transactions are reported in the Annual Performance Regulatory Information Notice (RIN) submission.

Energex considers it appropriate that section 3.2.1(a) not require a separate set of regulatory accounts given that this duplicates the RIN reporting requirements, however requests that this issue be clarified in the Final Guideline.

3.4 Cost allocation and attribution

Similarly, Energex supports an obligation to ensure that costs are attributed to distribution and non-distribution services.

A DNSP's CAM is the appropriate regulatory instrument to ensure the allocation of a DNSP's costs between its *distribution services* and non-distribution services.

Energex notes that the result of a DNSP achieving economies of scope across regulated and unregulated activities will mean that costs are shared across regulated and unregulated activities. Energex agrees that transparency in the way these costs are shared is appropriate.

¹ AER (2013), Expenditure Forecast Assessment Guideline for Electricity Distribution, p9-10

4 Obligations to address non-discrimination

Energex believes non-discrimination obligations are appropriate, however has concerns regarding the ambiguity and disproportionality of some of these obligations as discussed below.

4.1 General obligations

The Draft Guideline outlines a number of general obligations to address discrimination which are largely consistent with the current ring-fencing obligations that apply in Queensland. Energex considers the proposed obligations appear to be proportionate and likely to promote confidence in regulatory outcomes, however there is some ambiguity in the terminology and/or drafting namely the:

1. non-discrimination provision should apply to the DNSP's **provision** of distribution services only (rather than supply, and not extend to non-distribution service as set out in 4.1(a));
2. use of undefined term energy-related service in 4.1(b) (iv);
3. the need to use of a single and consistent terminology with respect to “competitive or contestable energy-related services” between the Draft Guideline (section 4.1(b)(iv)) and the Explanatory Statement.

Appendix 1 sets out alternative drafting to clarify the scope of 4.1(a) and offers an appropriate definition for energy-related services. Energex expects that compliance with these obligations can be achieved within 3 months of commencement of the guideline with the exception of 4.1(b)(v) and 4.1(b)(vi) which relates to separate branding.

4.2 Functional separation

Section 4.2 of the Draft Guideline establishes obligations for functional separation. These are new obligations and represent a very significant change from the existing ring-fencing arrangements. Therefore, Energex is extremely concerned that the requirements appear ambiguous and disproportionate.

4.2.1 Physical Separation

Clause 4.2.1 requires physical separation of a DNSP's direct control services from related parties providing energy-related services. The example provided in the Draft Guideline states that:

a DNSP must operate in a different building, and prevent staff from mixing in the normal course of undertaking work activities.²

The Draft Guideline does not define energy-related services, which makes it difficult for DNSPs to understand and comply with their ring-fencing obligations. Energex considers that in the interests of predictability and confidence in regulatory outcomes, the Final Guideline should define energy-related services. Energex suggests that an appropriate definition might be “electricity services other than distribution services or transmission services, that are provided to end users on a contestable or competitive basis” (see Appendix 1).

The costs for Energex to comply with the obligations requiring physical separation will be significant, noting that contractual arrangements for the lease of property will need to be varied. Energex considers the physical separation requirements to be severe and disproportionate to the harm the AER seeks to prevent. Energex considers that the AER can ensure that a DNSP does not confer a competitive advantage to its own related party with less onerous physical separation obligations, such as separate floors with restricted swipe card access. This solution would impose significantly lower compliance costs and achieve a similar if not the same outcome. Furthermore, Energex notes that DNSPs do not have any control regarding separate service providers of energy-related services being a tenant of the same office/building as the DNSP. Energex recommends the removal of “separate service providers” under section 4.2.1(a).

Energex also seeks consistency between the staff sharing and physical separation obligations. Clause 4.2.2(b) of the Draft Guideline includes a range of exceptions to the staff sharing obligations. Presumably, the AER has identified these exceptions on the basis that the sharing of these staff does not pose a risk of discrimination against other service providers in energy-related services markets, due to their insignificant direct involvement in either the regulated distribution business or relevant energy-related business. Energex considers that for the same reasons the AER has recognised it appropriate that such staff be exempt from staff sharing obligations, so too should they be exempt from the physical separation obligations. Energex has set out at Appendix 1 alternative drafting that would ensure parallel application of the staff sharing exceptions as for physical separation.

4.2.2 Staff Sharing

Energex acknowledges that the AER has made a number of material changes from the preliminary positions paper to address stakeholder concerns particularly in regards to sharing of staff who do not present a risk of discrimination (such as staff who perform corporate functions). Energex considers the Draft Guideline has gone some way to distinguishing between unfair advantage and DNSPs’ legitimate advantages associated with economies of scale and scope, which benefit customers in both distribution and non-distribution markets. For example, the ability to share corporate staff allows DNSPs to

² AER (2016), Draft Ring-Fencing Guideline Electricity Distribution, p5

provide distribution services more efficiently and as such is in the long term interests of customers.

The Draft Guideline requires Energex to ensure that staff directly involved in the provision of a direct control service are not involved in the marketing or the provision of a contestable energy-related service for a related party.

Energex reiterates its view that an appropriate definition of energy-related service is required. Energex considers that it is critical for the AER to remove the ambiguity around this term to ensure compliance requirements are clear. It will also assist with reducing the number of potential compliance cases and potentially reduce the number of applications for waivers.

In particular, where DNSPs are providing emergency support to other NSPs, Energex considers that these services should be classified as a distribution service thereby facilitating the sharing of staff (and materials). Energex agrees with the AER's interpretation of this activity being resource sharing rather than a service that is offered to customers.³

Energex notes that in determining the services that the proposed obligations should apply to, the ring-fencing guideline should require an assessment of the potential for development of competition in the relevant market. The cost of ring-fenced services may increase in the short-term due to loss of efficiencies from reduced workforce flexibility, noting that prices may remain higher in the longer term if competition does not develop. Energex considers that a competition assessment should form part of the waiver test which is discussed later in this submission.

4.3 Information access and disclosure

With regard to the information access and disclosure requirements, Energex recognises the need to protect information flows such that a DNSP cannot use information obtained in providing distribution services to also provide an inappropriate competitive advantage to its related body corporate. However, the obligations set out under the Draft Guideline far exceed this purpose in that they seek to address the protection of confidential information generally, which Energex believes is adequately addressed under the NER. As such the Draft Guideline appears disproportionate and appears to fail the necessity principle.

Section 4.3 of the Draft Guideline places obligations on DNSPs in relation to restricting information disclosures. Energex supports the intent of these obligations. The NER have long-established and effective confidentiality provisions under clause 8.6 that apply to all DNSPs. Energex considers that the proposed obligations extend beyond the existing NER obligations and are unworkable as currently drafted.

³ AER (2016), Draft Ring-Fencing Guideline Explanatory Statement, p54

In particular, Energex considers clause 4.3.1 regarding protection of information is unnecessary and should be removed, given clause 8.6.1(b)(2) of the NER requires DNSPs to only use the information for the purpose for which that information was provided.

Clause 4.3.2 relates to the sharing of information such that third parties competing with a DNSP's related body corporate have access to information on an equal basis. While Energex supports the apparent intent of this obligation, which is to seek to remove the potential for preferential treatment around information sharing and complements general obligations under clause 4.1(b)(iv), Energex considers the proposed drafting overreaches in terms of its objective and could result in unintended consequences. In particular the drafting refers to information broadly as opposed to commercially sensitive information which is where the discrimination issue arises. In addition, Energex considers that the scope of the obligation should be limited as to apply only to information provided to a related body corporate in relation to the related body corporate's energy-related services. That is, it is important that information required to be shared within a corporate group for legitimate management and reporting services is not compelled to be disclosed. Energex has provided some alternative drafting at Appendix 1 which is more targeted to addressing the potential harm.

Clause 4.3.3 is unworkable and should be removed as it restricts the disclosure of all information to any party without explicit informed consent. Based on the current drafting, DNSPs would not be able to provide any information to the AER, to shareholders, contractors performing work on behalf of Energex and possibly the market as required under the NER. Moreover the requirement for explicit informed consent sets a very high threshold for approval and increases administrative costs significantly. This would result in additional costs for little or no benefit to customers given that confidentiality obligations in the NER already apply to address the harm the AER seeks to prevent, and there is no obvious requirement for this additional provision, to prevent the potential harm that the AER has identified in the Guideline.

In the interests of proportionality and predictability, Energex recommends that the ring-fencing guideline rely on the NER confidentiality provisions and only consider additional obligations where there is a clear additional need to address the harm the AER is seeking to prevent. This approach would result in the removal of clauses 4.3.1 and 4.3.3 entirely and the retention of a modified clause 4.3.2 as set out at Appendix 1.

5 Waivers

The Draft Guideline narrowly restricts waiver applications to functional separation obligations only. Energex considers that waivers in relation to legal separation obligations should be provided for, at least until such time as consistency is able to be achieved in the F&A process across all DNSPs and jurisdictions.

Energex also considers that the AER's assessment of a waiver application needs to be broader than assessment of achievement of the NEO. The objective of the ring-fencing guideline is to seek to avoid monopoly businesses from using their market power in the provision of distribution services to adversely impact competitive markets.

Energex considers that the waiver application test needs to consider the prevailing market conditions to assess the potential impact on competitive markets of granting a waiver. For example, there may be services markets, particularly in regional areas, where a fully contestable market is unlikely to eventuate. Energex encourages the AER to consider the compliance costs that ultimately customers will bear for little or no benefit. In a situation where competition does not eventuate, customers are likely to face higher costs than the status quo.

Energex has a number of existing waivers granted by the AER that will be impacted by the new ring-fencing guideline. A number of these waivers are primarily focused on research and development or innovation, which Energex considers necessary for the efficient future provision of distribution services.

For example, the solar PV installation at Eagle Farm and the Battery Energy Storage System (BESS) trial at Rocklea were established to better understand the network impacts of large commercial solar PV and battery installation on the network. Energy exported to the grid is either zero or immaterial and is not being sold to customers or retailers. Furthermore, the results of the Rocklea BESS trial will be published so that all interested parties can benefit from the learnings.

Energex considers that research and development activities, such as pilots and trials, should not be subject to the legal and functional separation provisions of the ring-fencing guideline. The rapidly changing innovative technologies and emergence of new products will mean that DNSPs will be undertaking an increasing number of trials to better understand the possible benefits to customers of utilising these new technologies in the provision of network services. If the Guideline was to apply to these trials, the AER will likely see a significant increase in waiver applications to avoid the functional separation requirements.

Furthermore, the interaction between the Draft Guideline and the Demand Management Incentive Scheme (DMIS) is not clear. DMIS and pilots are necessary activities for a DNSP to undertake to ensure efficient delivery of network services into the future and therefore are appropriately undertaken by the DNSP, not a legally and functionally separated related

entity. Given that the pilots and trials must relate directly or indirectly to the provision of regulated network services, the ring-fencing provisions proposed to apply to DNSPs in the Draft Guideline will prevent anti-competitive harm. For example, information disclosure provisions will prevent DNSPs from sharing the results with their related party unless also publishing to the total market.

To simplify administration of this automatic partial waiver from the ring fencing guideline, Energex proposes that a DNSP should be required to notify the AER of all relevant pilots and trials that it is undertaking in its annual compliance report (clause 6.2.1).

6 Compliance and enforcement

Section 6.2.1(b) of the Draft Guideline requires Energex to undertake a compliance assessment by a qualified independent authority. Energex considers that this obligation should be further clarified to define the compliance assessment as a limited assurance review rather than an audit. A full compliance audit is likely to be particularly costly given the lack of clarity in the Guideline. This will also likely result in a higher number of non-compliance cases with many obligations open to wide interpretation.

More generally, Energex considers that a key driver of minimising compliance costs is removing the ambiguity in the Draft Guideline, particularly around the scope of services that the proposed obligations apply to. This ambiguity will make it difficult for a DNSP to determine how best to ensure compliance through changed systems and processes and will lead to higher compliance costs than would otherwise be the case.

7 Transitional arrangements

The transitional arrangements proposed in the Draft Guideline are inadequate and will impose significant compliance costs, particularly resulting from the functional separation requirements. A longer transition period would minimise the costs and is not unreasonable given the limited competitive harm Energex presents in existing contestable services markets it serves.

For example, with a longer transition period for functional separation, Energex will have time to develop a plan for its property moves and sequence them to minimise costs. Without proper planning there is a risk that staff will be moved multiple times to achieve the required outcome. In developing a property plan, Energex will also need review its existing property leases and enter into negotiations with lessors to potentially break leases and/or novate to another party. A greater transition period to allow this to occur in a more planned and structured manner will lead to lower costs for customers. Energex strongly suggests that the timing of transitional arrangements be aligned for legal and functional separation, given the activities and costs associated with achieving compliance.

Energex also considers that the transitional arrangements in the Draft Guideline should be expanded to address changes to obligations over time. For example, a DNSP's F&A decision will play a central role in determining the services required to be ring-fenced, however it is subject to change each regulatory period. The F&A decision does not become final until such time as the AER publishes its final determination, usually two months prior to the commencement of the regulatory period. Where a change in service classification would require it to be legally and/or functionally separated, Energex considers that two months will be insufficient time to develop and implement changed systems and processes to ensure compliance with its ring-fencing obligation. Moreover, there is the potential for service classification to change in the AER's final distribution determination. Energex recommends that the ring-fencing guideline should provide for a 12 month transition following a DNSP's final determination that includes changes to its classification of services.

Energex's recommended implementation timetable is:

- 3 months after the commencement date of the guideline for separate accounts/cost allocation and non-discrimination obligations (with the exception of branding)
- 12 months after the commencement date of the guideline for legal and functional separation as well as separate branding obligations
- A 12 month period following a distribution determination where services are reclassified.

Drafting reflecting Energex's proposed transitional arrangements is at Appendix 1.

APPENDIX 1

Alternative Drafting

Appendix 1: Alternative Drafting

Issue	Clause	Proposed Alternative Drafting				
Definition of “ network services ”	Unclear in application	Replace reference to “ network services ” in 3.1 with “ distribution services and transmission services ”				
Definition of non-network services	Not defined	Replace reference to “ non-network services ” with services other than distribution services and transmission services				
Definition of “ distribution services ”	Not defined	<p>“distribution services” mean:</p> <ul style="list-style-type: none"> a) those services classified as distribution services in the DNSP’s Distribution Determination; and b) until the date the DNSP’s next Distribution Determination takes effect, the transitional included distribution services; c) any new services offered by the DNSP within the period of a Distribution Determination period that meet the definition of a “distribution services” under the National Electricity Rules. <p>“transitional included distribution services” means, for a jurisdiction in which a DNSP’s distribution system is located, the included distribution services listed in Appendix B to this Guideline.</p> <p>Appendix B</p> <table border="1" data-bbox="591 1026 2009 1153"> <thead> <tr> <th data-bbox="591 1026 880 1074">Jurisdiction</th> <th data-bbox="884 1026 2009 1074">Transitional included distribution services</th> </tr> </thead> <tbody> <tr> <td data-bbox="591 1077 880 1153">Queensland</td> <td data-bbox="884 1077 2009 1153">a) all services classified as “non-distribution services” in the Queensland F&A decision</td> </tr> </tbody> </table> <p>Note: the term “ring-fenced services” could also be used in place of “distribution services”, to avoid any potential confusion with the NER definition of “distribution services”</p>	Jurisdiction	Transitional included distribution services	Queensland	a) all services classified as “non-distribution services” in the Queensland F&A decision
Jurisdiction	Transitional included distribution services					
Queensland	a) all services classified as “non-distribution services” in the Queensland F&A decision					
Definition of “ energy-related ”	Not defined	“ energy-related services ” mean electricity services other than distribution services or transmission services , that are provided to end users on a contestable or competitive basis				

Issue	Clause	Proposed Alternative Drafting
<i>services</i> "		
3.1 Waivers for "distribution services" legal separation	There is currently no scope for waivers of the legal separation obligation in 3.1	<p>Section 3.1 should be amended to allow for waivers as follows:</p> <p>3.1 Legal separation</p> <p>a) A DNSP must be a legal entity and, subject to clause 3.1(b) and (e), must only provide distribution services or transmission services.</p> <p>b) A DNSP may incur costs of up to \$500,000 (identified and allocated in accordance with clause 3.2.2) in any regulatory year for providing services other than distribution or transmission services (excluding any services the subject of a waiver granted in accordance with Section 5).</p> <p>c) For the avoidance of doubt, clauses 3.1(a) and 3.1(b) do not prevent a related body corporate of a DNSP from providing services other than distribution or transmission services</p> <p>d) For the avoidance of doubt, clauses 3.1(a) and 3.1(b) do not prevent a DNSP and a TNSP being the same legal entity.</p> <p>e) A DNSP may apply for a waiver of the obligations set out in clause (a) in accordance with the waiver process set out in Section 5.</p>
4.1 General obligations not to discriminate		<p>Amend wording as follows:</p> <p>(a) 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 provision of distribution services.</p>
4.3.2 Sharing of Information		<p>A DNSP must ensure that, where commercially valuable information acquired in providing direct control services and/or regulated transmission services (including information derived from that information) is made available to a related body corporate in relation to energy-related services provided by the related body corporate, it is also made available to third parties competing with the related body corporate in relation to the same or similar energy-related services.</p>
Appendix A – Transitional Arrangements	Currently transition periods of 12 months for clause 3.1(a) and 6 months	<p>Appendix A – Transitional arrangements</p> <p>Despite clause 1.1, the obligations identified in the table below commence on the corresponding date in the table.</p>

Issue	Clause	Proposed Alternative Drafting	
		Section	Commencement Date
	for clauses 4.2.1 and 4.2.2 are inadequate	3.2, 4.1(i)-(iv)	3 months after the commencement date
		3.1, 4.2, 4.3 and 4.1(v) and (vi) (branding)	a. 12 months after the commencement date b. Where a DNSP's subsequent Distribution Determination results in the reclassification of services, 12 months after the commencement data of the subsequent Distribution Determination in relation to any new obligations arising in relation to those reclassified services.
4.2.2 Staff Sharing	The exceptions available in section 4.2.1 relation to staff sharing should also be available in relation to the restrictions on physical separation/co-location	<p>Suggest that sections 4.2.1 and 4.2.2 be reworded as follows:</p> <p>4.2.1 Physical separation/co-location</p> <p>(a) A DNSP must operate physically separate offices for the provision of direct control services and regulated transmission services from the offices from which any of its separate service providers or related bodies corporate provides other energy-related services. For example, a DNSP must operate in physically separate offices, and prevent staff from mixing in the normal course of undertaking work activities.</p> <p>(b) The obligation set out in clause 4.2.1(a) is subject to the following exceptions:</p> <p>i. Office accommodation for permitted staff ; or</p> <p>ii. Any arrangements agreed through the waiver process set out in Section 5 of this Guideline.</p> <p>4.2.2 Staff sharing</p> <p>(c) A DNSP must ensure that its staff directly involved in the provision of a direct control service or a regulated transmission service are not also involved in the provision or marketing of a competitive or contestable energy-related service by a related body corporate.</p> <p>(d) A DNSP must not remunerate or otherwise incentivise its staff (other than a staff member who is a senior executive of both the DNSP and a related body corporate) based on the performance of a related body corporate.</p> <p>(e) The obligation set out in clause 4.2.2(a) is subject to the following exceptions:</p>	

Issue	Clause	Proposed Alternative Drafting
		<ul style="list-style-type: none"> iii. Sharing of permitted staff ; or iv. Any arrangements agreed through the waiver process set out in Section 5 of this Guideline. <p>4.2.1 Permitted Staff</p> <p>For the purposes of clause 4.2.1 and 4.2.2, the following staff are permitted staff:</p> <ul style="list-style-type: none"> (f) staff of the DNSP's separate service providers or related bodies corporate that are not involved in the provision of energy-related services; (g) a member of staff who is a senior executive of both a DNSP and a related body corporate; or (h) a member of staff who is not directly involved in the provision of any direct control services or regulated transmission services, and who therefore do not have access to information about electricity customers and services, such as staff who exclusively perform corporate services, for example in payroll and human resources; or (i) a member of staff who is involved in the provision of a DNSP's negotiated distribution services and unregulated distribution services; or (j) Any staff authorised through the waiver process set out in Section 5 of this Guideline.