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Dear Sir

### **Electricity Distribution Ring-Fencing Guidelines Review – Discussion Paper**

Essential Energy appreciates the opportunity to respond to the Australian Energy Regulator's (AER's) discussion paper titled Electricity Distribution Ring-Fencing Guidelines Review ('the discussion paper'). Essential Energy's responses to the questions contained in the paper are detailed below.

Is ring-fencing an appropriate means of addressing the problems that vertical integration of DNSPs may give rise to? If not, what is an appropriate regulatory method?

Essential Energy believes that ring-fencing is an appropriate method of addressing the problems that vertical integration of DNSPs may give rise to, provided the requirements are both cost effective and practical for DNSPs to comply with.

Is a national set of Distribution Ring-Fencing Guidelines desirable under the current regulatory framework? Are the current guidelines and provisions of the CCA sufficient to deal with the issues that vertical integration poses?

Essential Energy supports the consolidation of various state based regulations into national guidelines where possible, provided national guidelines simplify compliance for market participants, can be easily understood by users and improve existing regulatory frameworks. However, Essential Energy believes that a national set of distribution ring-fencing guidelines will be difficult to implement in NSW due to the unique existence of the contestability framework.

Essential Energy is required to comply with distribution ring-fencing guidelines developed by the Independent Pricing and Regulatory Tribunal of NSW ('the IPART guidelines') and with the provisions of the Competition and Consumer Act 2010 (CCA). Essential Energy believes that the IPART guidelines and the CCA have been

operating effectively in conjunction with the NSW contestability framework for a number of years in dealing with any issues that vertical integration poses.

In our opinion the main benefits of a national set of guidelines is that:

- they would provide a nationally consistent set of guidelines for users in all jurisdictions, and
- in the longer term it would be more economical for one regulatory body to administer, monitor, enforce and change a single set of guidelines.

Are the current enforcement mechanisms sufficient to ensure effective compliance by DNSPs with their ring-fencing obligations?

Current enforcement mechanisms are sufficient to ensure compliance by DNSPs with ring-fencing obligations.

Are the existing jurisdictional guidelines still appropriate in light of recent developments in the industry structure and the regulatory framework governing DNSPs? If not, why?

Existing guidelines are still appropriate in light of recent developments in the industry structure and the regulatory framework.

In Essential Energy's opinion, the IPART guidelines accomplish two practical objectives in NSW. The first is to ensure that Accredited Services Providers (ASPs) can compete on a level playing field with DNSPs under the NSW contestability framework. The contestability framework has been operating effectively in NSW for many years.

The second objective of the ring-fencing guidelines is to ensure that cost shifting by regulated businesses does not occur. Essential Energy's cost allocation method, which is independently audited each year, allocates costs incurred and revenues received to either a direct control or unregulated service on a causation basis in accordance with the IPART guidelines. This prevents DNSPs distorting the market and lessening competition.

Essential Energy believes that these objectives have not been impacted by the privatisation of the retail operations of the state owned DNSPs and the IPART ring-fencing guidelines are still appropriate in NSW.

Are there matters that the Transmission Ring-Fencing Guidelines deal with that a national set of Distribution Ring-Fencing Guidelines should not?

The current transmission ring-fencing guidelines (the transmission guidelines) require TNSPs to comply with a number of additional requirements that the current IPART guidelines do not impose on NSW DNSPs. If those obligations were included in a national set of distribution ring-fencing guidelines they would result in a significant increase in administrative costs without increasing competition or benefits to customers.

What matters should distribution ring-fencing guidelines address and what is the appropriate way to deal with such matters?

At a high level distribution ring-fencing guidelines should ensure that DNSPs do not exercise market power which would provide them with an advantage over other participants to the detriment of an efficient market.

At a practical level, and as noted above, the main matters that the current DNSP ring-fencing guidelines address in NSW are:

- ensuring that ASPs can compete on a 'level playing field' with DNSPs under the contestability framework; and
- ensuring that cost shifting between regulated and unregulated activities does not occur.

The IPART guidelines appropriately deal with both of these matters.

Are there any problems with the content of the current jurisdictional guidelines? In what ways could they be improved?

Essential Energy has not had any problems with the content of the IPART guidelines it has been operating under.

Whilst there are no problems with the current jurisdictional guidelines an important element of them is that they allow participants to apply for waivers from the guideline. Essential Energy currently has waivers for two requirements of the current guideline. The waivers were requested because of the unique geographical nature of Essential Energy's business. Compliance with those parts of the ring-fencing guideline would have been extremely costly to consumers, impractical to implement and would have reduced service standards without having any impact on competition.

If a national set of guidelines is developed, it will be important that waivers are allowed for in appropriate circumstances.

Should the AER work to develop a set of national guidelines that apply consistently across all participating jurisdictions?

As noted above Essential Energy supports the consolidation of various state based regulations into national guidelines where possible. However, the contestability framework in NSW makes it difficult to implement a single set of ring-fencing guidelines in the short term.

Given the diverse requirements of current jurisdictional schemes and the differing maturity levels of contestable services across jurisdictions, Essential Energy believes that it may take some time to transition from existing ring-fencing guidelines to a national standardised approach. As other jurisdictions open up more services to contestability in the future, a convergence into a single set of guidelines may be possible over a longer timeframe.

A review of the costs and benefits of moving to a set national set of guidelines versus maintaining the current set of jurisdictional schemes also needs to be

conducted, particularly where current jurisdictional schemes are operating effectively.

Regardless of the consistency of ring-fencing guidelines across jurisdictions, it will be necessary to maintain the ability for DNSPs to apply for waivers where appropriate, meaning consistent application across all jurisdictions may not be possible even under a single national guideline.

Does the current structure of the NEM mean that distribution ring-fencing guidelines are no longer necessary?

The privatisation of the retail operations related to NSW state owned DNSPs has separated the distribution and retail functions in NSW. This may have removed some of the concerns of jurisdictional regulators regarding those two functions, however it has not changed the fact that several state owned DNSPs continue to operate in both regulated and competitive environments.

The IPART guidelines apply to Essential Energy in exactly the same manner now as they did prior to the sale of the NSW retail businesses. To ensure that competition is not restricted by regulated businesses in existing contestable markets, and to ensure that services are provided as efficiently, and at the lowest cost possible, such ring-fencing guidelines are still necessary.

How should distribution ring-fencing guidelines be modified to account for changes in the electricity supply industry?

The IPART guidelines are operating effectively and, at present, do not require modification to account for changes in the electricity supply industry.

How should the generation of electricity by DNSPs to offset energy consumption be dealt with in any ring-fencing guidelines? Should there be an exception to allow such consumption, should it be capped, or should it be prohibited?

The generation of electricity by DNSPs to offset energy consumption or improve energy efficiency should not be dealt with by ring-fencing guidelines and should not be capped or prohibited.

Capping or prohibiting the production of renewable energy would contradict policies aimed at increasing the production of renewable energy. DNSPs should not be discouraged from producing renewable energy merely because they are distribution businesses. Essential Energy is pursuing an overall corporate strategy of reducing energy consumption and facilitating the use of renewable energy, therefore a prohibition or cap would be detrimental to that strategy.

Requiring DNSPs to apply for waivers or exemptions each time they were considering installing renewable generators would add to the administrative cost of installing the renewable generators and may discourage the production of renewable energy and demand management solutions.

DNSPs also use generators to comply with licence requirements and provide network support. If generation was capped or prohibited the only effect would be to require Essential Energy to apply for waivers for generators in cases such as this.

The paper questions whether DNSPs are generating electricity as an incidental part of their businesses or on a larger scale. In Essential Energy's case electricity generation is either part of an overall internal corporate strategy to increase the production of renewable energy on a small scale to offset its own use, or as part of network support.

As part of research and development into demand management solutions, Essential Energy is also actively developing energy storage technology that, at times, will generate electricity to reduce peak demands. At present Essential Energy has no plans to generate electricity on a larger scale.

Do the current jurisdictional ring-fencing guidelines inhibit effective innovation in the market for new contestable services? If so, how could a revised set of ring-fencing guidelines address this?

The IPART guidelines do not inhibit the market for new contestable services. They outline several requirements for DNSPs regarding services, information, cost allocation, communication and functional separation whilst retaining the flexibility for DNSPs to obtain waivers where appropriate. The IPART guidelines have not inhibited innovation, and have worked effectively in conjunction with the contestable framework in NSW.

Essential Energy would be pleased to discuss this matter further with the AER. Should you require further information please feel free to contact Jason Cooke on 02 6338 3685.

Yours sincerely



Col Ussher

**Executive General Manager Infrastructure Strategy**