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By email: AERinquiry@aer.gov.au

Dear Mr Pattas

Thank you for the opportunity to comment on the AER's position paper on the development of ring-fencing guidelines for electricity distribution.

We agree in principle with the AER's observation that current jurisdictional ring-fencing guidelines are overdue for review and that a nationally consistent approach is preferable to the alternative of developing and maintaining separate jurisdictional instruments. However, Jemena is concerned that, apart from expressing a preference for a national guideline, the AER's position paper gives no meaningful guidance as to the direction that the AER might take in formulating a distribution ring-fencing guideline. In Jemena's view there should be further informal consultation so that stakeholders can have clearer understanding of the AER's intentions in relation to a number of important aspects of a guideline before the AER initiates the formal consultation process required by section 6.17.2(d) of the NER.

The AER's preferred position and its implications

The AER's preferred position and preliminary view are developed out of a discussion of possible ring-fencing obligations and their application which includes a statement that:

Given the variety of circumstances that may need to be addressed, both in terms of the nature of the market concerns and the jurisdiction involved, it may be preferable for the guidelines to operate in a more flexible way. This could mean, for example, the guidelines applying any of the possible ring-fencing obligations, on a case-by-case basis. In addition, to provide further flexibility, the guidelines would incorporate waiver and variation provisions to allow for appropriate application of specific obligations. In that way, the guidelines will be able to effectively address a variety of circumstances that currently exist in the NEM and upstream or downstream markets, and remain relevant into the future. ¹ (emphasis added)

The combination of "applying any of the possible ring-fencing obligations on a case-by-case basis"—which we assume is about providing for variations between jurisdictions (NER s6.17.2(a))—and "waiver and variation provisions", suggests that each jurisdiction and each DNSP will potentially be

¹ AER, Electricity Distribution Ring-fencing Guidelines, Position Paper, September 2012, p11.

subject to a different set of requirements. This degree of flexibility would appear to be inconsistent with the stated rationale for a NEM-wide guideline which is that “the markets for provision of many unregulated services are not limited by state borders, and participants in those markets will be better served by consistent ring-fencing arrangements across the NEM”.² A national guideline that provides for case-by-case application would be national in name only.

The AER goes on to state a preliminary view that “the distribution guidelines should allow for the following obligations to be imposed:

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

This statement is of no assistance in understanding the AER’s position because it simply says that DNSPs could be subject to any or all of the elements of a ring-fencing scheme that are provided for in section 6.17.2(b) of the NER plus three additional elements namely physical, staffing and functional separation; non-discrimination; and compliance and reporting. The critical unanswered question is what processes and criteria does the AER propose to adopt to determine which of those elements should apply, and in what way, to a particular service and/or DNSP.

Section 6.17.1 of the NER requires that “All Distribution Network Service Providers must comply with the Distribution Ring-Fencing Guidelines prepared in accordance with clause 6.17.2.” It is difficult to see how a single document with NEM-wide application can offer the flexibility envisaged by the AER’s preliminary position, and at the same time be framed so that the obligations that apply to each separate DNSP or group of DNSPs are stated explicitly. It would be helpful if the AER could explain how it plans to deal with this.

We believe the AER should also be in a position to state now that any ring-fencing guidelines it makes:

- will not require legal separation
- will not impose accounting separation and cost allocation requirements

and

- will take full account of the costs and benefits of the obligations that the guidelines impose.

We stated our position on each of these matters in our submission in response to the AER’s discussion paper. If the AER cannot rule out a requirement for legal separation then it must address the issues that we raised in that submission. We also noted in that submission that accounting and cost allocation matters can already be dealt with through the cost allocation methods established under section 6.15.4 of the NER and the AER’s existing information gathering powers.

Identifying services that should be ring-fenced

In the position paper, the AER cites the need to foster the contestable provision of services in “emerging markets” as a principal justification for developing ring-fencing guidelines now. In Jemena’s view a critical aspect of any guideline will be the process and criteria to be applied in assessing whether a new service should be ring-fenced and, if it is to be ring-fenced, then what

² *ibid.*

specific ring-fencing requirements should attach to that service. Unfortunately the position paper gives no insight into the AER's thinking on this important matter.

Historically, it has been a relatively simple task to identify and define the services and activities, such as generation and retailing, that require ring-fencing. In future, there are likely to be many new services, and it will be more difficult to identify and define those that are truly candidates for contestable provision and hence should be subject to ring-fencing. For example, in our response to the discussion paper we noted that certain services, such as load control services, must remain within the control of the DNSP if they are to deliver the intended benefits to consumers. We went on to propose a three part test that should be applied to each service or class of services that might be considered for ring-fencing:

- Is the service properly a candidate for contestable provision?
- What features of existing arrangements are inhibiting the development of competition?
- What is the proportionate response?

Next steps

We are concerned at the apparent urgency with which the AER is now approaching this review and the development of guidelines. The AER published its directions paper in December 2011, almost 4 years after section 6.17 was first included in the NER. Now, in September 2012 and 7 months after submissions closed on the discussion paper, the AER has published a position paper requiring submissions within 4 weeks and foreshadowing a process leading to the publication of a guideline in March 2013. That process will involve consultation over the Christmas/New Year period.

The AER should not initiate the formal consultation process to develop a guideline (NER s6.17.2(d)) until stakeholders have a clearer understanding of its intentions for a guideline, including details of the processes and criteria it proposes to apply when assessing whether a new service should come under the guideline and, if it does, then what ring-fencing requirements should attach to the service. Further preliminary consultation is required.

Should you wish to discuss this submission, please contact me on 02 9455 1551 or by email at warwick.tudehope@jemen.com.au.

Yours sincerely



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