



TasNetworks

Ring-Fencing Compliance Report

September 2019

TasNetworks Ring-Fencing Compliance Report

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1. Overview

1.1 Background

On 30 November 2016, the Australian Energy Regulator (**AER**) released the Electricity Distribution Network Ring-Fencing Guideline (**Guideline**). The Guideline was developed as a requirement of the National Electricity Rules (**NER**) to prevent cross-subsidisation and discrimination where Distribution Network Service Providers (**DNSPs**) provide direct control services and other services, or where entities affiliated of the DNSP (**affiliated entities**) provide other services. DNSPs are bound by The Guideline, including its subsequent updates.

The Guideline which came into effect on 1 December 2016, requires DNSPs to report compliance against the Guideline each year. Throughout the 2018-19 regulatory year, Tasmanian Networks Pty Ltd (ACN 167 357 299) (**TasNetworks**) and its affiliated entity, Fortytwo24 Pty Ltd (ACN 117 987 925) (**42-24**), have undertaken a number of compliance activities such as; balancing separate accounts; separating assets using cost allocation and attribution methods; adherence to disclosure, protection and sharing of confidential information policies; Guideline specific compliance training for affected staff and detailing exemptions, where they apply. This ring-fencing compliance report (**Report**) is TasNetworks' submission against the reporting requirements of the Guideline for the 2018-19 regulatory year.

1.2 Purpose

This Annual Ring-Fencing Compliance Report, for the year ended 30 June 2019, has been prepared by TasNetworks and is provided to the AER in accordance with requirement 6.2 Compliance Reporting, of the AER's Ring-fencing Guideline Version 2 – October 2017. TasNetworks does not claim confidentiality over this submission, and apart from circumstances outlined later in this Report, TasNetworks confirms it is in compliance with the Guideline.

1.3 Corporate Overview

TasNetworks differs from other DNSPs in that the business is an integrated transmission and distribution business. TasNetworks sought a waiver of clause 7.1(a)(ii) of the Transmission Ring-Fencing Guidelines to allow it to own and operate both the transmission business and the distribution business. TasNetworks was granted this waiver on 12 May 2014 and as such, the AER waived TasNetworks obligation to comply with clause 7.1(a)(ii).

Accordingly, we have made a key decision not to separate our transmission services from our direct control distribution services and to apply the NER definition of Transmission Services (which includes Prescribed, Negotiated and Unregulated transmission services). These services are able to continue to be provided together with regulated distribution services, with existing cost-allocation and asset sharing provisions continuing to apply. No further ring-fencing of Negotiated or Unregulated transmission services is therefore deemed necessary.

In recognition that TasNetworks would most probably provide some services that would not comply with the Guideline 42-24, previously called AuroraCom Pty Ltd, became a wholly owned subsidiary of TasNetworks Holdings from 1 July 2018. Since this time, TasNetworks created two more wholly owned subsidiaries of TasNetworks Holdings. They are:

1. Large Scale Renewables Pty Ltd; and
2. Marinus Link Pty Ltd.

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The relationships between the entities are shown below.

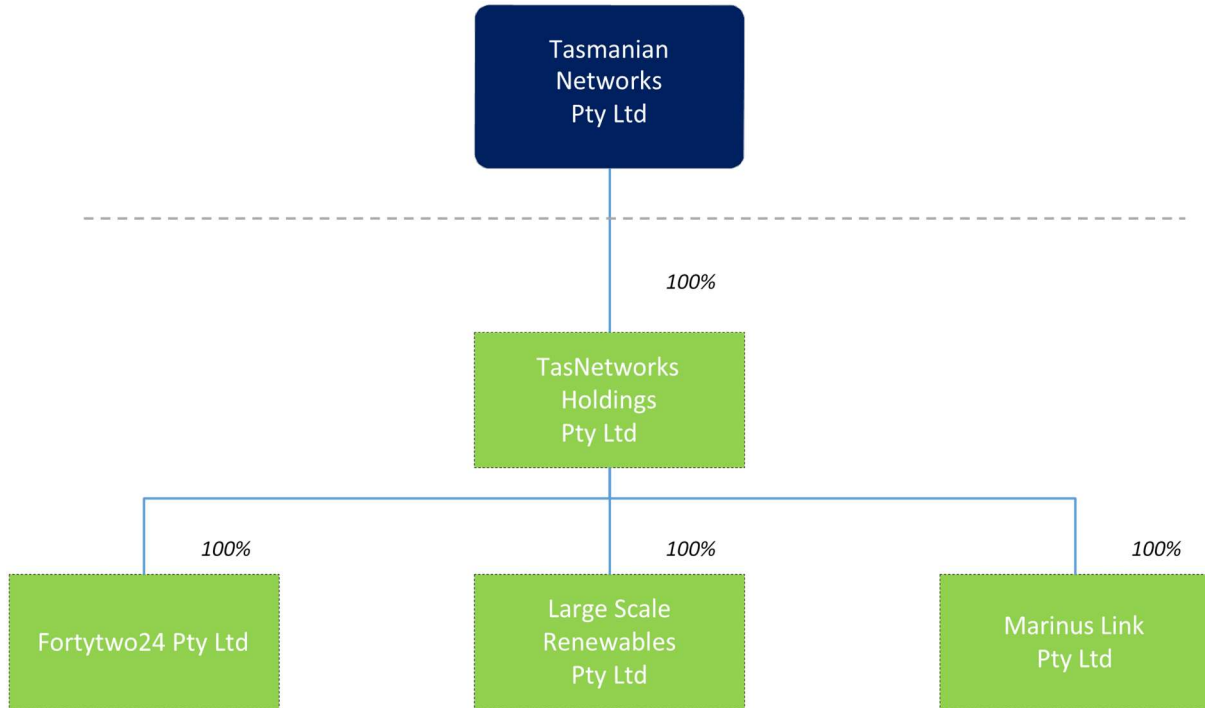


Image 1 - TasNetworks' Group Structure

Currently, 42-24 does not undertake any contestable electricity services, however it does undertake a number of 'other services' that require legal separation including:

- Telecommunications,
- Data centre services and,
- IT Services (including Infrastructure as a Service (**laaS**)).

Neither Large Scale Renewables Pty Ltd nor Marinus Link Pty Ltd provide distribution or other services.

Image 2 below illustrates the services attributable to each entity implemented under this Guideline

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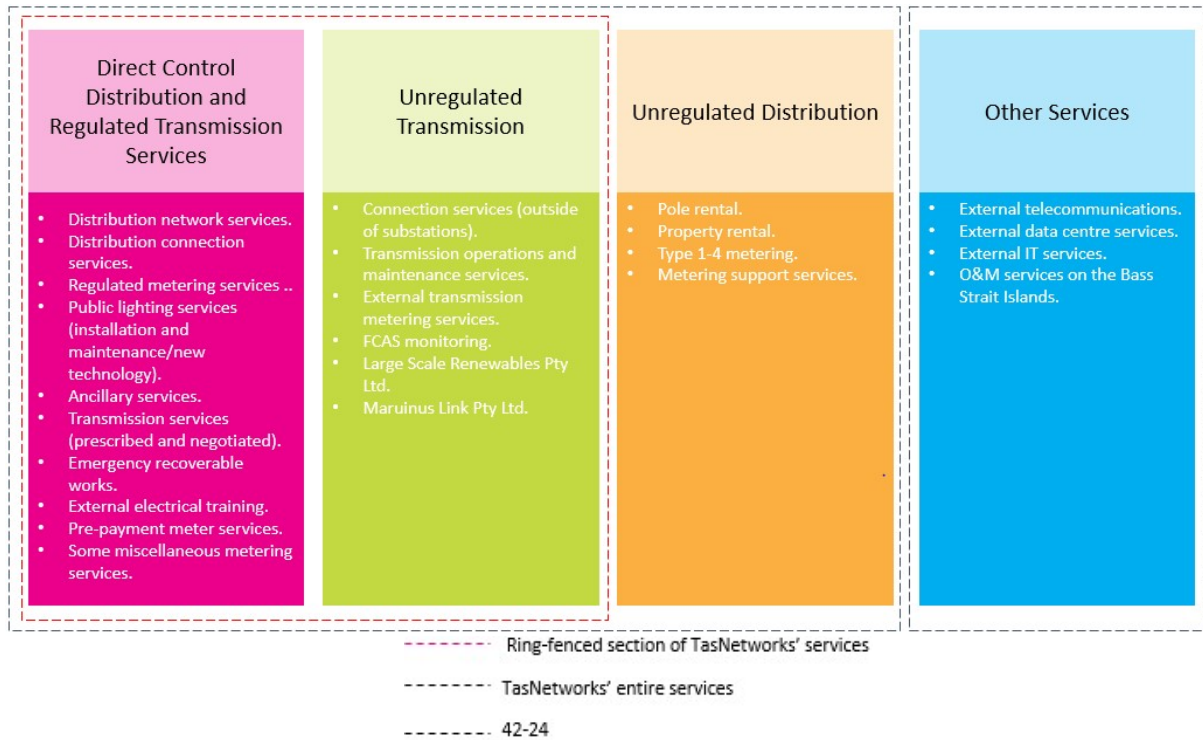


Image 2 – TasNetworks' Services

2. Measures to ensure compliance

Clause 6.2.1(b)(i) of the Guideline requires that the annual compliance report must identify and describe, in respect of the regulatory year, the measures the DNSP has taken to ensure compliance with its obligations under this Guideline.

A general ring-fencing training package is available for all TasNetworks employees and includes:

- an introduction to ring-fencing;
- an overview on obligations to not discriminate per 4.1 (b) and (c) of the ring-fencing guideline;
- hypothetical scenarios which may be encountered by TasNetworks people; and
- a short quiz.

Additional training has been implemented in 2018-19, targeting employees most likely to work in both the unregulated and regulated parts of the business. This training supported the Distribution Ring-fencing Information Protocol described in section 2.4.

Measures used to ensure compliance with specific Guideline clauses are provided in the following sections.

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2.1 Obligation to establish and maintain accounts

The following is an explanation of the procedures and processes used by TasNetworks to ensure that its distribution services have been classified as set out by the AER in the current Distribution Determination and do not contravene clause 3.2 of the Guideline.

Cost capture and financial management systems

TasNetworks' chart of accounts and costing systems have been established so that both operating and capital expenditure can be separately accounted for and reported in accordance with TasNetworks' AER approved Cost Allocation Method (**CAM**) and regulatory reporting requirements.

TasNetworks' principles, processes and policies all support compliance with the CAM. This includes the processes of attributing costs directly and of allocating shared costs to categories of service.

TasNetworks' cost allocation principles and policies consider the direct allocation of costs to:

- Direct Control Distribution services;
- Regulated Transmission services;
- Unregulated Transmission services;
- Unregulated Distribution services ;
- Other Distribution services; and
- Negotiated Distribution services.

Costs that are not directly allocated to one particular service type (e.g. overhead costs) are subject to a shared allocation of costs between the following:

- Direct Control Distribution services;
- Regulated Transmission services;
- Unregulated Transmission services;
- Unregulated Distribution services;
- Other Distribution services; and
- Negotiated Distribution services.

The chart of accounts structure enables costs to be attributed directly to the categories of services provided by TasNetworks or 42-24, or automatically allocates costs between them.

When costs are incurred they are allocated to the following chart of account dimensions in the financial systems:

- responsibility centre/department/cost centre - defined as the area in the business that is responsible for the work performed;
- functional area - defined as the nature of the work being performed and is also used to identify between capital and operating expenditure as well as the type of work and associated service classification (work category); and
- cost element/General Ledger code - defined as the nature of the costs incurred such as labour or contracted services.

The above dimensions form the basis of the cost hierarchy. Each dimension is assigned to a service classification. By establishing a clear relationship between dimensions and the categories of services, the financial systems ensure that costs are correctly attributed to the relevant service.

TasNetworks has 3 main types of costs:

- directly allocated or attributable costs (such as timesheet labour, materials, fleet, invoices for contracted services or via journal such as licences fees, etc.);
- on costs for labour, materials and fleet; and

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- shared costs (allocated on the basis of causal cost allocators).

2.2 Obligation not to discriminate

Clause 4.1 of the Guideline places the obligation on the DNSP to not discriminate (either directly or indirectly) between a related electricity service provider and a competitor (or potential competitor) of a related electricity service provider (**RESP**) in connection with the provision of:

- direct control services by the DNSP (whether to itself or to any other legal entity); and/or
- contestable electricity services by any other legal entity.

This obligation does not apply to TasNetworks as 42-24 is not engaged in the provision of contestable electricity services.

2.3 Offices, staff, branding and promotions

2.3.1 Physical separation/co-location

Clause 4.2.1(a) of the Guideline obligates the DNSP to use offices that are separate from any offices from which a RESP provides contestable electricity services.

This clause does not apply for TasNetworks as 42-24 is not engaged in the provision of contestable electricity services.

2.3.2 Staff sharing

Clause 4.2.2(a) of the Guideline obligates the DNSP to ensure that its staff involved in the provision or marketing of direct control services are not also involved in the provision or marketing of contestable electricity services by a RESP.

This clause does not apply to TasNetworks as 42-24 does not provide contestable electrical services.

2.3.3 Branding and cross promotion

Clause 4.2.3 (a) of the Guideline obligates the DNSP to use branding for its direct control services that is independent and separate from the branding used by a RESP for contestable electricity services, such that a reasonable person would not infer from the respective branding that the DNSP and the RESP are related.

The DNSP must not advertise or promote its direct control services and its contestable electricity services that are not direct control services together (including by way of cross-advertisement or cross-promotion).

The DNSP must not advertise or promote contestable electricity services provided by a related electricity service provider other than the DNSP itself.

While this clause does not apply to TasNetworks, as 42-24 does not provide contestable electrical services, TasNetworks has enacted controls to ensure content on its website does not breach clause 4.2.3(a).

2.3.4 Office and staff registers

Clause 4.2.4 of the Guideline obligates that the DNSP must establish, maintain and keep a register that identifies the classes of offices to which it has not applied clause 4.2.1(a) by reason of clauses 4.2.1(b)i. or 4.2.1(b)iii.; and the nature of the positions (including a description of the roles, functions and duties) of its members of staff to which it has not applied clause 4.2.2(a) by reason of clauses 4.2.2(b)i.a., 4.2.2(b)i.b., 4.2.2(b)iii. Or 4.2.2(d); and must make the register publicly available on its website.

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TasNetworks' Shared Office Register details all the shared offices where TasNetworks provides direct control services and contestable electricity services as defined by the Guideline. The [Shared Office Register](#) is available on TasNetworks' external website, as per the Guideline requirements. From 1 July 2018 to 30 June 2019 TasNetworks had no shared office through which contestable electricity services were provided.

TasNetworks' Shared Staff Register details all TasNetworks shared staff providing contestable electricity services as defined by the Guideline. The [Shared Staff Register](#) is available on TasNetworks' external website, as per the Guideline requirements.

2.4 Information access and disclosure obligations

TasNetworks has developed protocols and registers in the interests of protection of confidential information (clause 4.3.2 of the Guideline), the disclosure of information (clause 4.3.3 of the Guideline), the sharing of information (clause 4.3.4 of the Guideline) and the establishment of an information sharing register (clause 4.3.5 of the Guideline).

TasNetworks has published its [Information Sharing Protocol](#) on its external website, as per clause 4.3.4(d) of the Guideline. This document sets out the process through which TasNetworks will share information, pursuant to clause 4.3.4 of the Guideline, and the disclosure of information, pursuant to clause 4.3.3 of the Guideline.

TasNetworks' Information Sharing Protocol also contains a link to our information sharing register. TasNetworks' [Information Sharing Register](#) details all the legal entities who have requested to be included on the information sharing register and any confidential information that they have requested as defined by the Guideline. TasNetworks released its information sharing register on its external website, as per the Guideline requirements.¹

To assist staff with managing information within the TasNetworks Group (including with 42-24), TasNetworks has published an internal document titled Distribution Ring-fencing Information Protocol. This document addresses clauses from the Guideline associated with information access and disclosure. Additionally, a training program was developed and has initially been delivered to those teams identified as most likely to be impacted by the information sharing requirements in the Guideline.

2.5 Conduct of service providers

TasNetworks must ensure that any new or varied agreement between TasNetworks and a service provider includes provisions which require the service provider to comply with clause 4.4.1(a) of the Guideline. TasNetworks must also not directly or indirectly encourage or incentivise a service provider to engage in conduct contrary to clause 4.4.1(b) of the Guideline.

To ensure compliance with these obligations under the Guideline, TasNetworks undertook a review of our contract template to ensure all ring-fencing obligations are clearly defined.

3. Breaches

As required by Guideline clause 6.2.1(b)ii, TasNetworks has identified the following breaches which have been reported to the AER as per clause 6.3.

¹ Currently there is nothing reported on the Register since TasNetworks does not have a related entity providing electricity services.

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3.1 Bass Strait Islands

Under the Tasmanian Electricity Supply Industry Act, the responsibility for supplying and maintaining electricity to the Bass Strait Islands lies with Hydro Tasmania. Historically, Hydro Tasmania has contracted TasNetworks to provide operations and maintenance support services. Over time, these have included asset management, network design, training, back-up labour, logistics, meter data services, fleet management, provision of bespoke legacy BSI electrical manuals and the use of TasNetworks' customer service centre to facilitate fault dispatch services. However, as at the end of June 2017, TasNetworks was only providing a subset of these services, namely, provision of electrical manuals and fault dispatch services.

In September 2017, TasNetworks was granted a waiver by the AER to continue to provide these services until 30 June 2018. This was to cover the remaining period of the Hydro Tasmania-TasNetworks BSI service contract which expired April 2018. It was also provided to allow sufficient time for Hydro Tasmania to tender for and establish any new services required to fulfil its BSI obligations.

Subsequent to the completion of TasNetworks' 2017-18 ring-fencing audit, it came to light that Hydro Tasmania had retained access to the BSI electrical manuals. Further, that TasNetworks' customer service centre had received a small number of calls from BSI customers for which dispatch services were provided. Per ring-fencing obligations, the AER was immediately notified and over the course of January 2019 several meetings between the AER and TasNetworks took place. Ultimately, the AER decided that the breach was not material and no further action was deemed necessary. This was on the basis that:

- the provision of services was unlikely to have had any effect on contestable markets;
- TasNetworks was not seeking to continue to provide services to Hydro Tasmania;
- in fact, TasNetworks was only doing so, at no charge, to provide a community service to BSI residents; and
- that Hydro Tasmania was expected to finalise a new contractual arrangement with a party other than TasNetworks before financial year end.

Owing to a delay in Hydro Tasmania finalising the new contract arrangements, TasNetworks continued to provide BSI call dispatch services and access to the BSI electrical manuals until the end of the ring-fencing period.

3.2 Telecommunication contract novations

In preparation for the introduction of ring-fencing, TasNetworks identified 49 telecommunications contracts which would require novation from TasNetworks to 42-24. Owing to complex nature of the agreements and the time expected before novations could be completed, in September 2017, TasNetworks was granted a waiver to continue to provide the services until 30 June 2018.

TasNetworks identified the possibility that some of the more complicated novations might overrun the 30 June 2018 deadline. As a result, TasNetworks contacted all parties ahead of the waiver expiry and obtained verbal agreement to act as though the novations were in place whilst the documents were finalised. This included TasNetworks making necessary changes to the CAM and attendant processes to reflect proper cost allocation.

At waiver expiry, 13 contracts remained outstanding. However, owing to the pre-emptive measures put in place, expectation that contracts would soon be novated and the attendant lack of implications for the provision of contestable electricity services, TasNetworks did not submit a breach report considering the ring-fencing materiality threshold for reporting was not met.

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Despite TasNetworks continued efforts, over the course of 2018-19, little further progress on novating contracts was made. This was solely due to a lack of any incentive for counterparties to execute novation documentation. Owing to the slowed progress, TasNetworks informed the AER and sought advice on what further actions could be taken.

After initial conversations with the AER, TasNetworks lodged a breach report in March 2019. The AER responded in April 2019 informing TasNetworks that the AER considered TasNetworks to be in breach of Clause 3.1 of the Ring-Fencing Guideline. After further discussions with the AER, it was agreed that TasNetworks would submit an initial report by 31 May 2019, and quarterly thereafter, to inform the AER on the progress being made to transfer the remaining contracts.

TasNetworks submitted the initial report in May as requested. As at 30 June 2019, 12 contracts remain outstanding and TasNetworks continues to seek executed documents from contractual counterparties.

3.3 Correction of Minor Defects within Private Overhead Connections by TasNetworks Employees

One of TasNetworks' Strategic Goals is 'we care for our customers and make their experience easier'. In this respect, some of TasNetworks' overhead connection crews, when attending customer connection works, have been completing minor private electrical works, (which have not been performed by private electrical contractors) to ensure customer connection at the time rather than require multiple site visits.

Though this potential breach of clause 3.1(b) was identified outside the regulatory year for which this report covers, and is still in the process of being investigated, TasNetworks considered it prudent to include a summary of the potential breach and the preventative, detective and corrective controls and measures TasNetworks is considering taking in relation to this potential breach.

The breach was self-identified when an overhead connection crew sought guidance on the extent of private work they could perform to ensure a customer was connected in a timely manner to the distribution network. The crew was concerned that if they did not complete the work at the time, the customer would be left without supply and a further site visit would be required. In contrast the crew could complete the connection promptly and ensure the customer was connected that day. Once it was confirmed this had actually occurred, rather than being a hypothetical query, the breach was reported to the AER on 16 August 2019.

Since this potential breach of the Guideline, TasNetworks has looked for opportunities for re-education both internally and externally to support electrical contractors in understanding the work that can and cannot be performed by TasNetworks crews. We are also undertaking a review into ways to improve processes and procedures to allow for early identification of situations in the connection process with the potential for causing breaches. TasNetworks will work with the AER to find the best way to ensure customers receive the quality of connection service they expect while complying with the Guideline.

4. Other services

Clause 6.2.1(b)(iii) of the Guideline requires DNSPs to report all Other services provided by the DNSP in accordance with clause 3.1 of the Guideline. TasNetworks has been granted waivers for the provision of a number of services as detailed in 2.3 above. Excluding these, during the 2018-19 regulatory year, TasNetworks did not provide any Other services, that being services that are not transmission or distribution services.

5. Transactions with affiliated entities

TasNetworks and its affiliate 42-24 are parties to a Master Business Services Agreement under which TasNetworks provides 42-24 with:

- corporate services (which include Board, Company Secretary and General Counsel support, commercial services, financial analysis and reporting, information management, information technology and human resources);
- access to staff to perform work on behalf of 42-24; and
- access to assets for 42-24 to fulfil relevant contract obligations.

Corporate services are charged on either a fixed charge or do and charge basis. Access to staff and assets are charged based on relevant pricing principles that recover operating expenses, overheads and asset costs.

TasNetworks and 42-24 are also parties to an intercompany loan agreement, under which 42-24 is able to borrow funds from TasNetworks.

6. Waivers

6.1 Background

TasNetworks has two types of waivers, namely waivers:

- of a temporary or transitional nature, where the cost of complying immediately from the introduction of the Guideline would outweigh any benefits that would accrue in this timeframe; and
- that reflect the nature of the electricity sector in Tasmania in that there are no viable alternative providers of the service.

6.2 Temporary waivers

As part of the AER's Distribution Determination process for TasNetworks, the AER indicated during the framework and approach consultation process that it intended to re-classify a number of services. In response, and in line with the compliance strategy, TasNetworks sought a temporary waiver for these services to avoid unintended impacts and costs of separation, prior to them being reclassified as direct control services for the 2019-24 regulatory control period. This waiver was granted by the AER and was effective for the entirety of 2018-19. The waiver lapsed at the start of the new Regulatory period; 1 July 2019.

TasNetworks was also granted temporary waivers to provide:

- distribution support services on the Bass Strait Islands;
- Metering support services to Aurora Energy;
- legal separation extension; and
- Type 1-4 metering services.

These waivers were to provide added time for TasNetworks to remove itself from the provision of these services. Apart from the waiver for providing type 1-4 legacy metering services, these waivers had all expired prior to the start of the period covered by this report.

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TasNetworks sold the majority of its type 1-4 meters to another metering provider in March 2018. The few remaining meters were exchanged over time with the final meter being exchanged on 20 May 2019, prior to the end of the waiver period.

6.3 Waivers due to nature of electricity sector

In May 2019, TasNetworks sought from AER a waiver in respect to the obligations under the functional separation provisions for Aurora Pay As You Go² (APAYG) metering support services from 1 July 2019 to 30 June 2020. TasNetworks sought a waiver for the following provisions:

- 4.2.1 Physical separation/co-location;
- 4.2.2 Staff sharing;
- 4.2.3 Branding and cross-promotion;
- 4.2.4 Office and staff registers; and
- 4.4.1(a) Conduct of Service Providers

Specifically, TasNetworks sought a waiver with respect to the Guideline obligations relating to functional separation, and other obligations related to the provision of APAYG metering support services. The AER granted this waiver on 28 June 2019.

The reasoning for the waiver was that Aurora Energy indicated to TasNetworks its preference for TasNetworks to continue to provide APAYG metering support services beyond the expiry date of the then current ring-fencing waiver, which was due to expire on 30 June 2019. This was to allow Aurora Energy to fully decommission the remaining APAYG sites.

The waiver will allow TasNetworks to respond and rectify faults associated with APAYG meters outside of normal business hours, as well as provide APAYG metering support services.

The table below sets out the waivers granted to TasNetworks, and includes a description of the conduct to which the waiver applies, expiry date and clauses waived. A register of these waivers is kept up to date and made publically available via TasNetworks' website.

² Bespoke metering installations that are integrated with a payment fulfilment system that is reliant on a point of sale network where customers pre-pay for electricity to be transferred to the card operated meters.

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Table 1: TasNetworks' Waiver Register

Date waiver granted and commenced	Waiver title	Applicable services / conduct to which the waiver applies	Clauses waived	Expiry date of waiver	Status	Comments
18 December 2017	Re-classification waiver	The AER granted a waiver of TasNetworks' obligation (of the clauses outlined in the subsequent column) in relation to the following services: <ul style="list-style-type: none"> • high load escorts; • public lighting and nightwatchman lights; • network safety services; • planned interruption – customer requested; • inspection services; • minor and legacy metering services; and • Network related training courses. 	4.2.1 4.2.2 4.2.3 4.2.4 4.4.1(a)	30 June 2019	Expired	The waiver allows for TasNetworks to continue providing services that will be reclassified and become direct control services in the 2019-2024 regulatory control period.
18 December 2017	Legal Separation waiver	The AER granted TasNetworks a waiver to allow TasNetworks additional time to establish an affiliated entity and transfer all contestable services to that entity.	3.1	30 June 2018	Expired	The waiver allowed TasNetworks time to ensure that the necessary due diligence processes, legal and taxation advice and statutory requirements were in place prior to the establishment of the new affiliated entity (42-24).

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18 December 2017	Type 1-4 legacy meters	The AER granted TasNetworks a waiver to allow for the provision of type 1-4 metering services for a period of 18 months as TasNetworks transitions these meters to the new Metering Provider and can exit the market completely.	4.2.1	30 June 2019	Expired	
			4.2.2			
			4.2.3			
			4.2.4			
			4.4.1(a)			
18 December 2017	Metering Support Services	The AER granted TasNetworks a waiver so that it may continue to provide temporary metering support services to Aurora Energy under contract in Tasmania.	4.2.1	31 May 2018	Expired	TasNetworks exited the metering support services market prior to the 31 May 2018.
			4.2.2			
			4.2.3			
			4.2.4			
18 December 2017	Distribution support services on the Bass Strait Islands (BSI)	The AER granted a waiver of TasNetworks' obligations (of the clauses outlined in the subsequent column) so that it may continue to provide operations and maintenance support services to the BSI under a previous existing contract with Hydro Tasmania.	4.2.1	30 June 2018	Expired	
			4.2.2			
			4.2.3			
			4.2.4			
			4.4.1(a)			
1 July 2019	APAYG Metering Support Services	The AER provided TasNetworks with a waiver that enables TasNetworks to continue to provide fault response support, afterhours product support and bypass or removal (for customers who use life support equipment) of APAYG systems.	4.2.1	30 June 2020	Ongoing	
			4.2.2			
			4.2.3			
			4.2.4			
			4.4.1			