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United Energy Ring Fencing Waiver Application

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1. Overview

The Australian Energy Regulator's (AER) new Ring-fencing Guideline (Guideline) came into effect on 1 December 2016, although there is a transition period for some obligations until 1 January 2018.

This application seeks waivers from United Energy (UE) needing to comply with certain obligations in the Guideline so that it can continue, for the remainder of the current regulatory control period, to provide its negotiated distribution services, unclassified distribution services and unregulated distribution services on the same basis that it provided them before the Guideline took effect on 1 December 2016.

The specific services for which UE is seeking waivers are: public lighting – new public lights; public lighting – alteration and relocation of distributor public lighting assets; installation, repair, and maintenance of watchman lights; reserve feeder construction; possum guards; supply enhancements at the customer's request; and various other metering services not classified by the AER.

The specific obligations in the Guideline from which the UE is seeking waivers are:

- clause 4.2 relating to: physical separation / co-location (i.e. offices); staff sharing; and branding and cross-promotion.
- clause 4.4.1(a) relating to the conduct of its service providers.

UE considers that the AER should grant the requested waivers on the basis that:

- it will ensure continuity in the provision of the identified services to consumers for the remainder of the current regulatory control period. If the waivers are not granted then either:
 - the cost of UE providing these services will increase; or
 - UE will cease providing these services, where it has discretion to do so.
- the costs of complying with the obligations in relation to the identified services would far outweigh any benefits. Indeed, UE cannot see that there would be any benefits of it complying with the obligations for these services;
- there would be no "market harm" from UE continuing to provide the identified services on the current basis, as either:
 - the market for the service is already truly competitive; or
 - there is no competitive market for the provision of these services and UE is simply providing the services as and when requested by consumers.
- there are no cross-subsidies in the provision of the identified services.

If the AER grants these waivers then UE:

- will not make a pass-through application to recover the costs of ring-fencing compliance; and
- will actively engage with the AER about changing the classification of the identified services for the next regulatory control period.

2. Introduction

2.1 About United Energy

United Energy (UE) distributes electricity to approximately 665,000 customers across east and south-east Melbourne and the Mornington Peninsula, over an area of 1,472 square kilometres.

UE operates through a hybrid insource / outsource business model that optimises the mix of services to be provided internally and those to be procured through outsourced contracts. It has established best-practice procurement arrangements for those outsourced services. Most of UE's services are provided by its two service providers, Downer and ZNX.

The AER will be aware that UE recently changed ownership. This follows the purchase by the Cheung Kong Infrastructure (CKI)-led consortium of the DUET Group, which held a 66 per cent share of UE. This share was formally transferred to CKI on 15 May 2017, following approval by the Foreign Investment Review Board. The remaining 34 per cent of UE is owned by SGSP (Australia) Assets Pty Ltd.

The distribution licence continues to be held by UE and is unaffected by the change in ownership.

It is likely that UE will operate as a separate business, alongside CitiPower and Powercor.

Tim Rourke has been appointed Chief Executive Officer of United Energy. He will also continue in the role as Chief Executive Officer of the two other Victorian distribution network service providers (DNSP) CitiPower and Powercor.

2.2 AER's Ring-fencing Guideline and request for information

The Australian Energy Regulator's (AER) new Ring-fencing Guideline (Guideline) came into effect on 1 December 2016, although there is a transition period for some obligations until 1 January 2018.

The Guideline includes provisions for a DNSP to seek a waiver from the AER in relation to:

- legal separation provisions in clause 3.1 of the Guideline;
- offices, staff branding and promotions in clause 4.2; and
- service providers in clause 4.4.1(a).

Clause 5.2 of the Guideline details the information that must be included in a waiver application.

The AER wrote to UE on 17 February 2017 requesting that by 31 July 2017 UE submit:

- its ring-fencing compliance strategies;
- any ring-fencing waiver application; and
- any contemplated cost pass through applications.

This is UE's waiver application. UE will not make a pass-through application to recover the costs of ring-fencing compliance if the AER approves this waiver application. UE note the AER in its 17 February 2017 letter has provided an extended date for a pass through application of 11 May 2018. UE has provided a separate document to the AER detailing its ring-fencing compliance strategies.

2.3 Structure of this waiver application

This waiver application is structured to provide the information required by clause 5.2 of the Guideline:

- Section 3 details the services in relation to which UE is applying for waivers – it addresses clause 5.2(c) of the Guideline.
- Section 4 details the obligations in the Guidelines from which UE is applying for waivers – it addresses clause 5.2(a) of the Guideline.
- Section 5 details the proposed commencement date and expiry date of the waivers and the reasons for those dates – it addresses clause 5.2(d) of the Guideline.
- Section 6 details the regulatory control period to which the waivers would apply – it addresses clause 5.2(f) of the Guideline.
- Section 7 details the costs of complying with the obligations if the waivers are refused – it addresses clause 5.2(e) of the Guideline.
- Section 8 details the reasons why UE is applying for waivers – it addresses clause 5.2(b) of the Guideline.
- Section 9 details the reasons why UE considers the waivers should be granted – it addresses clause 5.2(h) of the Guideline.
- Section 10 details additional measures UE will undertake if the waivers are granted – it addresses clause 5.2(g) of the Guideline.

3. Details of services relevant to waivers

This section addresses clause 5.2(c) of the Guideline, which requires UE to detail the services in relation to which it is applying for the waivers.

Table 3-1 details the distribution services for which UE is seeking waivers and whether, and if so how, the AER classified them in its Final Decision for UE’s current regulatory control period, 1 January 2016 to 31 December 2020.

Table 3-1: Classification of services for which waivers being sought

Service	AER’s Service Classification for 2016 to 2020 period
Public lighting – new public lights	Negotiated distribution service
Public lighting – alteration and relocation of distributor public lighting assets	Negotiated distribution service
Installation, repair, and maintenance of watchman lights	Unclassified
Reserve feeder construction	Negotiated distribution service
Possum guards	Unclassified
Supply enhancements at the customer’s request	Unclassified
Other metering services not classified by the AER	Not regulated

3.1 Public lighting – new stand alone and green field public lighting

In its Final Decision, the AER classified standalone new public lighting, including public lights constructed by developers on green field sites and then gifted to UE, as a negotiated distribution service. The rationale for this approach set out in the AER’s Final Framework and Approach (F&A) paper was that the safety and technical requirements of the lighting and connection to the electricity network justify “a case for some regulatory oversight”¹. However, by classifying this service as a negotiated distribution service, the AER recognised that it “require(s) a less prescriptive regulatory approach because all relevant parties have sufficient countervailing power to negotiate provision of those services. Distributors and customers are able to negotiate services and prices according to a framework established by the rules”².

UE does not actively pursue the provision of these services and prefers that developers deal directly with councils. We also have no objection to councils owning and operating these lights. However, to date, no council in UE’s areas has taken up this option. In all cases to date these assets have been built by developers and gifted to UE to maintain and replace. In some cases, UE has constructed these assets at the request of a council – these cases are the exception.

UE’s current view is that this service should be unclassified by the AER in the next regulatory control period.

3.2 Public lighting – Alteration and relocation of public lighting assets

In its Final Decision, the AER classified the alteration and relocation of DNSP public lighting assets as negotiated distribution services. Again, this classification reflects the fact that this service “require(s) a less prescriptive regulatory approach because all relevant parties have sufficient countervailing power to negotiate

¹ AER, Framework and Approach – Victorian Distribution 2016-2020, 24 October 2014, page 61

² AER, Framework and Approach – Victorian Distribution 2016-2020, 24 October 2014, page 15

provision of those services. Distributors and customers are able to negotiate services and prices according to a framework established by the rules³.

UE's current view is that in the next regulatory control period this service should either be:

- treated as an unclassified distribution service by the AER, in which case UE may (if it applies for and is granted a waiver into the next period) or may not choose to continue to provide the service; or
- classified as an Alternative Control Service if there is an expectation that UE must continue to provide it.

3.3 Installation, repair and maintenance of Watchmen Lighting

Watchman lights (security lighting) are provided to business customers. The fee for this service covers the cost of a security light and all materials, including installation. In effect, the safety and technical considerations of lighting installation apply equally to this service and its connection into the electrical network. UE does not actively pursue this work and only undertakes it when specifically requested by a business customer.

The AER assessed watchmen lighting to be a contestable service in the current regulatory control period that is provided on a competitive basis. Accordingly, it did not classify this distribution service.

Our current view is that these services should remain as an unclassified distribution service in the next regulatory control period, in which case UE may (if it applies for and is granted a waiver into the next period) or may not choose to continue to provide the service.

3.4 Reserve Feeder Construction

A reserve feeder is a second connection from UE's distribution system to a customer.

In its Final F&A paper for the current regulatory control period, the AER noted that "We consider that customers have a range of technological options to secure their energy supply and thus, constructing a reserve feeder is an option that is subject to competition"⁴. The AER stated that it "considered whether this activity should be unclassified but, as there is a limited competition for this service we have accepted AusNet Services' proposal that it should be a negotiated service"⁵.

In practice, UE agrees that there is limited direct competition for the reserve feeder construction service. UE currently has approximately 20 reserve feeders. Although UE is required to tender out these works (excluding the network connection component), in all cases to date UE has provided the service in full.

UE's current view is that in the next regulatory control period this service should either be:

- unclassified by the AER, in which case UE may (if it applies for and is granted a waiver into the next period) or may not choose to continue to provide the service; or
- classified as Alternative Control Service if there is an expectation that UE must continue to provide it.

3.5 Possum Guards

The provision of possum guards is currently treated as an unclassified distribution service by the AER. The fee for this service applies to a customer who requires the provision of a possum guard to a service line. This fee covers the cost of a site visit to determine the requirements, a service truck and crew (based on the average time taken to undertake the work) plus materials used to perform the function.

³AER, Framework and Approach – Victorian Distribution 2016-2020, 24 October 2014, page 15

⁴AER, Framework and Approach – Victorian Distribution 2016-2020, 24 October 2014, page 16

⁵AER, Framework and Approach – Victorian Distribution 2016-2020, 24 October 2014, page 30

Given the safety and technical aspects of installing a possum guard on a distribution service line there is in practice limited competition in this service.

UE's current view is that this service should be classified as an Alternative Control Service in the next regulatory control period. UE is the only party that, in effect, can perform these works. The works are not contestable and there are limited circumstances in which they are required.

3.6 Supply enhancement at a customer's request

A customer can request a service to a higher standard than the least cost technically acceptable level of service. This service does not fall within a routine connection or a connection requiring augmentation.

The AER chose not to classify supply enhancements at a customer's request in the current regulatory control period. It is therefore an unclassified distribution service. The AER accepted the Victorian DNSPs' view "that the service has not been provided in the current regulatory control period, with the activities instead being provided as a routine connection or new connection requiring augmentation"⁶

UE's current view is that in the next regulatory control period this service should either be:

- unclassified by the AER, in which case UE may (if it applies for and is granted a waiver into the next period) or may not choose to continue to provide the service; or
- classified as Alternative Control Service if there is an expectation that UE must continue to provide it.

3.7 Other metering services not classified by the AER

The AER decided in its Final Decision for UE not to classify the following metering services in the current regulatory control period:

- installation, operation, repair and maintenance, and replacement of type 1-4 metering installations (excluding smart meters);
- collection of meter data, processing and storage of meter data, and provision of access to meter data for type 1-4 metering installations (excluding smart meters); and
- installation, operation, repair & maintenance, and replacement of type 5-6 metering installations (including smart meters) to new customers once metering competition commences in Victoria.

UE does not provide any of these services to end customers in the current regulatory control period. As a result, UE is not seeking a waiver for these services, although they are unclassified distribution services.

However, UE provides the following other metering services, which the AER did not refer to in its Final Decision for the current regulatory control period and which it therefore has not classified. UE considers these to be unregulated distribution services.

3.7.1 Time switch setting

A time switch may operate a dedicated off-peak load control circuit which supports the provision of an off-peak network tariff. Alternatively, a time switch may support the ongoing provision of off-peak load control, where the tariff no longer has a dedicated off-peak component, such as a net meter configuration to support a solar feed-in-tariff and a time-varying tariff.

⁶ AER, Framework and Approach – Victorian Distribution 2016-2020, 24 October 2014, page 43

No fee is charged in cases where the time switches are within a meter, such as an AMI meter or other electronic meter that is automatically maintained by the normal practice of time synchronisation to AEST.

A fee only applies to a customer who requests to have the time switch adjusted where it is determined that the time switch is set to the correct timing. Where the time switch is determined to be set incorrectly or out of time the time switch is adjusted free of charge.

This service is rarely used and, in the future, will become even less common, as the last of UE's manually read meters are replaced.

UE currently proposes that this service no longer be offered in the next regulatory control period and that the customer instead is required to have a meter exchange to an AMI meter.

3.7.2 Legacy metering services for +160MWh per annum customers

Metering services for customers who consume more than 160 MWh per annum are contestable services. Metering services for first tier customers who consume more than 160 MWh per annum include the provision, installation and maintenance of the meter and the manual reading data collection, data processing and storage and provision of the metering data to the market.

These first tier customers are serviced by legacy type 5 and 6 meters. The numbers of these meters have dwindled over time as legacy first tier meters need to be replaced or as the customer moves to a second-tier retailer, in which case a competitively provided type 4 meter is required for compliance with the NER.

3.7.3 Transitional metering services arrangements - +160MWpa customers and embedded networks

Customers who consume less than 160MWh per annum and then grow to the large classification in the NEM may have a manually read type 5 or 6 meter or a Victorian AMI type 5 meter with a regulated metering services charge. UE has processes in place to advise retailers of the need to change these meters to type 4 competitively provided meters, however the transition to competitive metering is ultimately up to retailers. These metering arrangements are part of the Order in Council Victorian deployment of meters.

Similarly, retailer requested metering for child embedded network customers may have type 5 or Victorian AMI type 5 metering where the retailer chose not to seek a type 4 competitive metering offering. Consistent with the type 5 DNSP provided metering obligations under the NER, Victorian AMI orders and the AEMO embedded network guideline which required the selection of the metering for embedded network children to occur in the same manner as a direct connection on the UE network, UE has provided some metering where requested.

The AEMC suggests that this regulated metering service for an embedded network child should not have occurred. Given the regulated or deemed Metering Coordinator contract provisions do not cover these meters, the AEMC has determined this to be a commercial service. UE intends to actively seek to remove our services in the Metering Coordinator, metering provisions and metering data provider roles for these second-tier children preferably prior to 1 December 2017. Again, this will be subject to the retailers' timely actions in this area. Until the site is no longer a UE NMI and UE is no longer in the metering roles, it is appropriate for UE to continue the status quo of providing these children arrangements with regulated metering services.

3.7.4 Customer access to metering data, type 1-4 metering installations

The NER requires UE to provide metering data to customers or their agents on request. DNSPs or retailers must provide this service when requested - it is not a contestable service.

4. Guideline obligations for which waivers sought

This section addresses clause 5.2(a) of the Guideline, which requires UE to detail the obligations in respect of which it is applying for the waivers.

UE is seeking the following waivers:

- A waiver under clause 4.2.5 of the Guideline of the obligations set out in clause 4.2 of the Guideline relating to:
 - Physical separation / co-location (i.e. offices);
 - Staff sharing; and
 - Branding and cross-promotion.
- A waiver under clause 4.4.2 of the Guideline of the obligations set out in clause 4.4.1(a) in relation to the conduct of its service providers.

5. Proposed commencement and expiry dates for waivers

This section addresses clause 5.2(d) of the Guideline, which requires UE to propose the commencement date and expiry date of the waivers and the reasons for those dates.

UE is seeking:

- the commencement date of the waivers to be 1 December 2016, when the Guideline took effect; and
- the expiry date of the waivers to be 31 December 2020, being the last day of the current regulatory control period.

The reason that UE is seeking these dates is that they cover the current regulatory control period for which the AER has already classified UE's distribution services in its Final Decision.

At the time of the AER making its Final Decision, the Ring Fencing Guideline was not in place. If UE is required to comply with the Guideline then, given the current service classification, it would need to change the basis on which the services in section 3 are provided. UE considers that it is not efficient to do this for the remainder of the current regulatory control period. It is seeking a waiver from these obligations for the remainder of the current regulatory control period only. UE will engage with the AER about changing the classification of the services in section 3 for the next regulatory control period.

UE is therefore seeking the waivers to continue to be able to provide its negotiated distribution services, unclassified distribution services and unregulated distribution services to consumers on the same basis that it provided them before the Guideline took effect on 1 December 2016.

6. Relevant regulatory control period

This section addresses clause 5.2(f) of the Guideline, which requires UE to detail the regulatory control period(s) to which the waivers would apply.

UE is seeking for the waivers to apply for the remainder of the current regulatory control period. This period covers 1 January 2016 to 31 December 2020 (although, as noted in section 5, UE only seeks the waiver from 1 December 2016, when the Guideline commenced).

7. Costs of complying with obligations if waiver refused

This section addresses clause 5.2(e) of the Guideline, which requires UE to detail the costs associated with it complying with the obligations if the waivers of the obligations are refused.

The costs that UE, and its service providers would incur, if it needed to comply with the Guideline in the current regulatory control period include:

- Establishing a new entity to provide these services;
- Establishing a new office to accommodate staff to provide these services;
- Relocating staff and “splitting” roles in certain area and functions – this would have the effect of UE and its service providers inefficiently incurring the cost of additional staff;
- Branding the new entity to provide these limited services; and
- Introducing new accounting and other systems to support the provision of these limited services

The cost of complying with these requirements would likely ultimately be borne by customers.

UE has not sought to quantify these costs for the purposes of this waiver application, as at this stage they have not been incurred. However, UE would quantify them in a cost pass through application if the AER does not grant these waivers.

8. Reasons for applying for waivers

This section addresses clause 5.2(b) of the Guideline, which requires UE to explain the reasons it is applying for the waivers. Given the heavily outsourced model, UE consider the reasons apply to both elements of the waiver application.

8.1 Continuity in the provision of services

UE is applying for these waivers to ensure continuity to consumers in the provision of its negotiated distribution services, unclassified distribution service and non-regulated distribution services detailed in section 3 of this application for the remainder of this regulatory control period.

UE provides the services in section 3 when consumers specifically request them from it. UE does not actively seek to provide these services. UE would be prepared to withdraw from the provision of these services but, in many cases, it cannot do so given requirements for it to provide them.

If these waivers are granted then UE will be able to continue to provide these services for the remainder of the current regulatory control period on the same basis that it has provided them before the Guideline took effect on 1 December 2016. If the waivers are not granted then either:

- The cost of UE providing these services will increase; or
- UE will cease providing these services, where it has discretion to do so.

In UE's view, either outcome would leave consumers worse off.

8.2 Avoid inefficient costs

In UE's view, the costs of complying with the ring-fencing obligations for the services listed in section 3 far outweigh any benefits from complying with them.

Section 7 of this application details UE's view of the nature of the costs that would be incurred, and likely passed on to consumers, if the waivers are not granted.

8.3 No "market harm"

UE recognises that market harm may arise if restrictions are placed on competitive markets.

In UE's view, it enjoys no particular competitive advantages in the markets for the services listed in section 3 either because:

- the market is already truly competitive; or
- there is no competitive market for the provision of these services and UE is simply providing the services as and when requested by consumers.

Consumers are free to request works of any party and may choose UE as a last resort.

Given that UE does not actively promote its capability in the provision of these services, it does not adversely affect competition in the provision of these services.

8.4 No cross-subsidies

There are no cross-subsidies in the provision of UE's services, including those listed in section 3. Its accounts are prepared in accordance with its Cost Allocation Method (CAM). The CAM has been approved by the AER and compliance with the CAM is audited annually as part of the annual Regulatory Information Notice process.

The new cost allocation requirements in the Guideline, from which UE is not (and cannot) seeking a waiver, further ensure that no cross-subsidies exist.

9. Reasons why waivers should be granted

This section addresses clause 5.2(h) of the Guideline, which requires UE to explain why the DNSP considers the waiver should be granted with reference to the matters specified in clause 5.3.2(a) of the Guideline, including the benefits, or likely benefits, of granting the waiver to electricity consumers.

UE considers that, by granting the requested waivers, the AER will positively promote each of the matters that it must have regard for in clause 5.3.2(a) of the Guideline. Specifically, as stated in section 10 of this application, the waivers will:

- promote the efficient delivery of distribution services by avoiding unnecessary and inefficient costs, consistent with the National Electricity Objective;
- have no negative effect on cross-subsidisation or discrimination for the provision of the services listed in section 3. These services are not currently subject to these effects and UE's continued provision of these services on the current basis will not impact them in any way; and
- the costs of complying with the obligations in relation to the services listed in section 3 would far outweigh any benefits. Indeed, UE cannot see that there would be any benefits of it complying with the obligations for these services.

10. Additional measures to be undertaken

This section addresses clause 5.2(g) of the Guideline, which invites UE to propose any additional measures that it would undertake if the waivers are granted.

The additional measures that UE proposes to undertake if the waivers are granted are to engage with the AER on:

- any proposed new service classification guideline that it may introduce in the coming years, which it would apply to the classification of UE's services for its next regulatory control period, commencing 1 January 2021; and
- the AER's process for developing its F&A Paper for the next regulatory control period, in which it will set out its proposed approach for the classification of UE's services.

Where necessary, UE will seek for the services listed in section 3 to be reclassified through these processes to avoid the need for it to apply to the AER for any further waivers in the next regulatory control period.