



28 September 2012

United Energy
43-45 Centreway
Mt Waverley VIC 3149
PO Box 449
Mt Waverley VIC 3149
T 03 8846 9900
F 03 8846 9999
www.ue.com.au

Our Reference: UE.01

Mr Chris Pattas
General Manager
Network Regulation South
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Email: chris.pattas@aer.gov.au

AER Electricity Distribution Ring-fencing Guidelines- Position Paper

Dear Chris

United Energy (UE) welcomes the opportunity to provide comments on the AER Position Paper titled, Electricity Distribution Ring-fencing Guidelines.

NEM wide ring fencing guideline

The AER has undertaken a review of the existing jurisdictional ring fencing guidelines for both transmission and distribution. The AER concludes that there are three main issues with the current jurisdictional arrangements;

1. the content and application of the guidelines vary significantly. The significant differences between the jurisdictional guidelines make it difficult for the AER to develop a consistent approach for monitoring compliance with ring-fencing obligations;
2. there has been limited review of most of the jurisdictional guidelines since their implementation, meaning that their continuing relevance and adequacy has not been examined;
3. changes to the current ring-fencing obligations need to be made to ensure the arrangements are appropriate for emerging contestable markets.¹

¹ AER, Electricity Distribution Ring-fencing Guidelines, Position Paper, September 2012, p14

Based on these findings, the AER has concluded that it is more efficient to develop a national distribution ring fencing guideline. The AER has proposed an approach where a draft national ring fencing guideline would be made available in November 2012 and finalised by March 2013.

UE considers that the timeframes proposed by the AER do not allow appropriate consideration of the ring fencing criteria and the benefits of one approach over another. This level of methodical consideration is required to ensure that any change is in the long term interests of consumers and not left with suboptimal outcomes. The AER considers that a NEM wide ring fencing guideline would enable effective ring fencing of regulated businesses choosing to participate in emerging contestable markets and would allow the markets to operate efficiently and effectively in the long term.

The AER considers that a NEM wide ring fencing guideline would be more efficient and intends to allow a transitional period to restructure business arrangements;

'The AER recognises that any changes to existing distribution ring-fencing guidelines will require the implementation of new arrangements by the DNSPs. The AER will allow an appropriate time to facilitate the transition of existing services to new arrangements. The transition period will provide DNSPs time to restructure business arrangements to comply with the ring-fencing guidelines, or apply for a waiver or variation, in circumstances it can demonstrate these are appropriate.²

UE is concerned that a move to national arrangements may require a restructure of business arrangements. Any restructuring of business arrangements has the potential to reduce efficiencies already embedded in distribution service charges and may result in increased costs to customers at a time when energy affordability is already a significant concern.

Need to substantiate increased ring fencing and increased costs

Statements regarding business restructuring appear to force a structural separation of monopoly network and SMI related services. Before the AER proceeds with such an approach there needs to be methodical consideration of the benefits and costs to consumers of the different models of structural separation or enhanced regulatory intervention.

UE is concerned that the Hilmer report has been cited that where a natural monopoly element is vertically integrated with a potential competitive activity it should be fully structurally separated. This is not a presumption that has been implemented in a blanket fashion in practice: rather governments pursued a range of structural separation and reform solutions tailored to the costs and benefits of individual circumstances.

It is unclear why a number of existing regulatory tools are considered deficient for SMI services:

- Existing cost allocation rules;
- Regulatory information gathering powers;
- Capacity to regulate the access to services to require non-discriminatory and equivalent treatment; and
- Capacity of the regulator through audited regulatory accounts to identify and address cross subsidisation.

² AER, Electricity Distribution Ring-fencing Guidelines, Position Paper, September 2012, p16

Level of prescription in NEM ring fencing guideline

The AER is interested in the views of interested parties on how prescriptive the ring-fencing guidelines should be in specifying the application of particular ring-fencing obligations to address particular concerns.³

The AER considers that there are two broad approaches to the operation of the ring fencing guidelines:

- Prescriptive approach - Under a more prescriptive approach the guidelines would set out the particular ring fencing obligations that would apply to address relevant market concerns. This approach assumes that the ring fencing obligations are uniquely and always suited to address a particular market concern. The AER note that this arrangement will be more rigid and a less effective regulatory requirement than is necessary.
- Less prescription, case by case approach - Given the variety of circumstances that may need to be addressed, both in terms of the nature or the market concerns and the jurisdiction involved, it may be preferable for the guideline to operate in a more flexible way. For example the guidelines could apply any of the ring fencing obligations on a case by case basis.

In either case the guidelines will provide for waiver and variation provisions to allow for appropriate application of specific obligations and cater for existing markets and remain relevant into the future.

UE is of the view that the development of any national electricity distribution ring fencing guideline should be limited largely to a review of the jurisdictional guidelines.. Any national ring fencing guidelines should be at the principle level and not at a prescriptive level of detail.

The MCE and the Victorian Government supported a mandated roll out of advanced interval meters on the basis of a number of customer benefits and the fact that no one party received all of the benefit and hence was unlikely to take the initiative and voluntarily roll out interval meters. A number of the benefits span distribution functions, metering services and new services. Any significant structural or operational separation should not be required until it is determined that the benefits are justified against the costs such that any significantly changed approach is in the long term interests of consumers.

If the AER requires prescriptive and onerous requirements through the revised ring fencing arrangements then demand management services may not evolve. Where the ring fencing obligations are too costly, distributors may not provide these services potentially resulting in higher network prices for the next few decades. The AER needs to be fully aware of the implications of the ring fencing arrangements and the customer interface with demand management services and network augmentation. There are costs associated with additional obligations and compliance requirements that may be placed on the distributors, there are also costs associated with these markets not emerging as they otherwise would.

A heavy handed ring fencing guideline will inhibit distribution activities. Distributors have extensive knowledge on networks and load management and may be able to develop solutions that are low or zero incremental costs. Distributors should be entitled to provide customer services and load management services. Distributors should not be prevented from providing (or required to provide at higher cost) decent services to customers to help them manage their load or provide consumption information. Ring fencing guidelines should not label services that then outlaw a common sense approach to providing customer service and load management services.

³ AER, Electricity Distribution Ring-fencing Guidelines, Position Paper, September 2012, p18

Peak demand is growing and with solar, customer profiles are becoming peakier; customers don't want prices to increase unnecessarily so there is a need to deliver benefits for consumers. Distributors are in a position where they may be able to help deliver these benefits for customers where they are not forthcoming via other areas of the market.

The AER also needs to take into consideration that large retailers may lock customers into deals which may have an adverse impact on retail competition and retail prices.

The Position Paper provides no indication of the processes and criteria the AER will use to determine which of the ring fencing obligations should apply and how they apply for particular services. UE would welcome the opportunity to discuss these matters further with the AER before the Draft Guideline is issued in November.

Should you require any clarification on our response please contact me on (03) 8846 9856.

Yours sincerely

Verity Watson

Manager Regulatory Strategy

United Energy