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Electricity Distribution Ring Fencing Guidelines Review – Discussion paper

Dear Chris

United Energy (UE) appreciates the opportunity to provide comments on the AER Discussion Paper, Electricity Distribution Ring Fencing Guidelines Review.

The AER considers that there are two main issues with the current ring fencing arrangements:

- The significant differences between these jurisdictional guidelines meaning that ring fencing of DNSPs differs across jurisdictions; and
- There has only been limited review of the jurisdictional guidelines since their implementation, meaning that their continued adequacy and relevance has not been examined.

UE is of the view that the jurisdictional regulators would have updated the ring fencing guidelines if they had perceived a regulatory failure or need and that the jurisdictional differences are likely to reflect the nature of the ownership of the distributors and retailers and the level and timing of separation which has occurred in many of the jurisdictions.

UE consider in light of NECF and the significant changes in the jurisdictional regulatory frameworks, the numerous market reviews etc, these should be allowed to be finalised and considered before developing any national ring fencing arrangements. This will allow efficient market structures or processes to be established with any ring fencing arrangements as an overlay should they be necessary.

Given the different starting points and activities in each jurisdiction, a one size fits all approach to ring fencing is not appropriate. Any ring fencing approach needs to consider not only the industry structure but also each of the services.

UE recognises that the use of monopoly infrastructure to provide services which may be considered competitive may need to be reviewed. However any new service would need to be considered on a case by case basis. The AER should only consider ring fencing arrangements where the benefits outweigh the costs on a case by case basis for each regulatory service.



UE's response to the AER questions is attached.

Please feel free to call me on (03) 8846 9856 if you wish to discuss any aspects of this response.

Yours sincerely

Verity Watson
Manager Regulatory Strategy

Response to AER Questions

AER Question	UE Response
<p>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?</p>	<p>The current ring fencing guidelines cover non-discrimination, information sharing, operational separation and branding, marketing and customer communications to ensure that a distributor does not discriminate in favour of its integrated retail business.</p> <p>DPI state that ' There are no integrated retail and distribution businesses in Victoria. Therefore it is not considered necessary to retain this guideline, whether or not the AER publishes its guideline in the foreseeable future.'¹</p> <p>UE support this approach and note that the Victorian guidelines have not been updated since they were finalised in 2004 which means that there is no market failure.</p>
<p>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?</p>	<p>UE caution against a one size fits all ring fencing arrangements given the different distribution ownership arrangements and distribution service arrangements across jurisdictions. The implicit assumption that the ability of the distributor to discriminate in upstream or downstream activities at any level needs to be considered. The NEO is seeking to promote efficient investment in and efficient operation and use of electricity services in the long term interests of consumers. Whilst on one level this may seem to be served best by competition in these activities, this assumption needs to be tested for each service on a case by case basis.</p>
<p>Are the current enforcement mechanisms sufficient to ensure</p>	<p>UE are not aware of any breach of the Victorian guidelines by retailers</p>

¹ DPI Discussion Paper – Victoria-Specific Regulatory Requirements Under The National Energy Customer Framework, July 2011

<p>effective compliance by DNSPs with their ring-fencing obligations?</p>	<p>or distributors. On this basis the enforcement mechanisms would appear to be sufficient.</p>
<p>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?</p>	<p>Given there are no integrated retail and distribution businesses in Victoria, UE agree with the Victorian policy position that these ring fencing guidelines are no longer required.</p>
<p>Are there matters that the Transmission Ring-Fencing Guidelines deal with that a national set of Distribution Ring-Fencing Guidelines should not?</p>	<p>UE is generally supportive of appropriate cost allocation, however the transmission ring fencing guidelines would seek to discourage consideration of alternatives such as generation where there are network or transmission constraints which have the potential to impact customer supply reliability. These would be considered related business, any generation to support avoiding network augmentation would need to be ring fenced, yet would also be an integral part of managing ongoing supply reliability.</p>
<p>What matters should distribution ring-fencing guidelines address and what is the appropriate way to deal with such matters?</p>	<p>The AER needs to consider the incentives in the overall regulatory framework that encourage reliable demand reduction and increased network utilisation in order to provide an appropriate balance in cost vs services to consumers. Whilst the paper notes that ring fencing guidelines can limit the ability of a DNSP to discriminate against upstream and downstream competitors there is no consideration of how the NEO may be best met.</p> <p>The matters under NER 6.17.2 (b) are reasonable to include in ring fencing guidelines, with the exception of legal separation. Any legal or operational separation should be implemented by legislation or by a rule change. Consideration of the NEO and impacts to the regulatory framework under which a distributor provides services need to be considered based on industry structure and based on each service. UE would be concerned if the AER could require significant change to the business like legal separation through a guideline given the significant impact that this would have to the business. These are</p>

	important and costly arrangements to implement and need to be part of legislation or Rules rather than a guideline.
Are there any problems with the content of the current jurisdictional guidelines? In what ways could they be improved?	The content of the current jurisdictional guideline have served their purpose and should be repealed.
Should the AER work to develop a set of national guidelines that apply consistently across all participating jurisdictions?	<p>UE consider in light of NECF and the significant changes in the jurisdictional regulatory frameworks, the numerous market reviews etc, these should be allowed to be finalised and considered before developing any national ring fencing arrangements. This will allow efficient market structures or processes to be established with any ring fencing arrangements as an overlay should they be necessary.</p> <p>UE consider that it is premature to develop national ring fencing arrangements in light of these significant changes. If any national arrangements were developed, they would need to be based on the lowest common denominator. As with all national processes it is difficult, if not impossible to develop arrangements that cater for a one size fits all where the starting points are quite different.</p>
If not how should the inconsistencies across jurisdictional guidelines be dealt with?	Refer to the response above.
Does the current structure of the NEM mean that distribution ring-fencing guidelines are no longer necessary?	The paper notes that the industry context has changed substantially since the jurisdictional regulators first developed jurisdictional guidelines, including a significant number of changes in ownership structure in most jurisdictions. With this in mind, many of the businesses have complete separation or alternative measures in place to ensure no abuse of power, UE consider that ring fencing guidelines are no longer necessary.
How should distribution ring fencing guidelines be modified to	The paper notes a number of areas where services may be developed and suggests that these services be considered as contestable and

<p>account for changes in the electricity supply industry?</p>	<p>hence ring fencing is considered necessary by the AER to ensure that DNSP's are not cost shifting between regulated and unregulated activities. The paper suggests that the starting point of these arrangements is different in each jurisdiction and can only be dealt with at the time of any new service classification in a framework and approach paper.</p> <p>The timing of price reviews and the recognition of NSW ASP schemes suggest that nationally consistent ring fencing is unlikely to be workable.</p>
<p>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?</p>	<p>Where a business is making a decision as a matter of good corporate citizenship to offset emissions from business activities using generation then it would be inefficient and inappropriate for ring fencing to prohibit such an arrangement. Where a DNSP was seeking to profit or earn more than the 5% revenue threshold then the generation activity could be considered necessary for approval.</p>
<p>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?</p>	<p>As mentioned above the jurisdictional ring fencing arrangements in Victoria can be repealed.</p> <p>UE does not consider that revised ring fencing arrangements are necessary. UE would be concerned if the ring fencing arrangements were seeking to inhibit innovation and effective service delivery across the market where there are not currently problems, particularly in a services market that has yet to develop or emerge.</p> <p>UE recognises that the use of monopoly infrastructure to provide services which may be considered competitive may need to be reviewed. However any new service would need to be considered on a case by case basis, one size does not fit all. The AER should only consider ring fencing arrangements where the benefits outweigh the costs on a case by case basis for each regulatory service.</p>