

Our Ref: **D19/91821**
Contact Officer: **Olivia Boyd**
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28 June 2019

Ms Jodi Cowdery
Assistant Director, Utilities Commission
GPO Box 915
DARWIN NT 0801

Dear Ms Cowdery,

2019 Northern Territory Electricity Ring-fencing Code and Guidelines Review Issues Paper

Thank you for the opportunity to comment on the Utilities Commission's review of the *Electricity Ring-fencing Code and Guidelines*. This submission provides insights from the AER's experience of developing and enforcing compliance with the first nationally consistent ring-fencing guideline for electricity distribution networks, which may be relevant to the review. I also note that from July 2019, Power and Water Corporation (PWC) is required to comply with the AER's *Electricity Distribution Ring-fencing Guideline* (subject to a number of derogations as set out in the Northern Territory National Electricity Rules, or NT NER).

We found that defining ring-fencing objectives that are fit-for-purpose is an important first step. When we developed the AER's Ring-fencing Guideline in 2016, part of our task involved reviewing jurisdictional ring-fencing guidelines in the NEM and developing an updated set of objectives. The jurisdictional guidelines, which were developed in the early-2000s, were mostly focused on supporting the structural separation of competitive generation and retail services from monopoly network services. The AER's Ring-fencing Guideline had to encompass a more complex landscape of contestable services, including unbundling of competitive metering from regulated network services, the increasing role of third-party distributed energy resources (DER) in the NEM, and the at times blurry boundary between regulated and unregulated services.

The framework we adopted in developing the AER's Ring-fencing Guideline focussed on controls to avoid the potential harms (cross-subsidy and discrimination) stemming from distributors' relationships with affiliates operating in contestable markets. However, the framework allows us to exempt distributors from compliance with the Guideline via waivers where the risk of harm is minimal. This flexibility allows us to have a robust ring-fencing

approach that is also flexible, enabling a proportionate response that can be tailored to specific circumstances.

Effective compliance monitoring and enforcement is important for the success of any ring-fencing regime, particularly as markets for contestable electricity services become more complex. We have adopted a number of tools to support distributor compliance with the AER's Ring-fencing Guideline, including annual independent assessments by third parties. In our experience, this third party assessment has been critical and provides additional confidence to the market.

We appreciate that the Northern Territory has a unique set of operating conditions that make it different from other jurisdictions in the NEM. Nonetheless, we see merit in the ring-fencing framework being aligned across jurisdictions, to the greatest extent practicable. We expect that this would reduce the cost of compliance, which is ultimately borne by electricity customers.

To assist in the Utilities Commission's Review, Attachment A provides further detail on relevant aspects of the AER's *Electricity Distribution Ring-fencing Guideline*, and how the Ring-fencing Guideline will apply to PWC from 1 July.

I understand our staff have been in regular contact on these matters and we are more than happy to provide assistance where we can. Should you have any further questions about our submission please contact Olivia Boyd on (02) 6243 1248 or olivia.boyd@acr.gov.au.

Kind regards,



Angela Bourke
A/g General Manager, Consumers and Markets

Appendix A

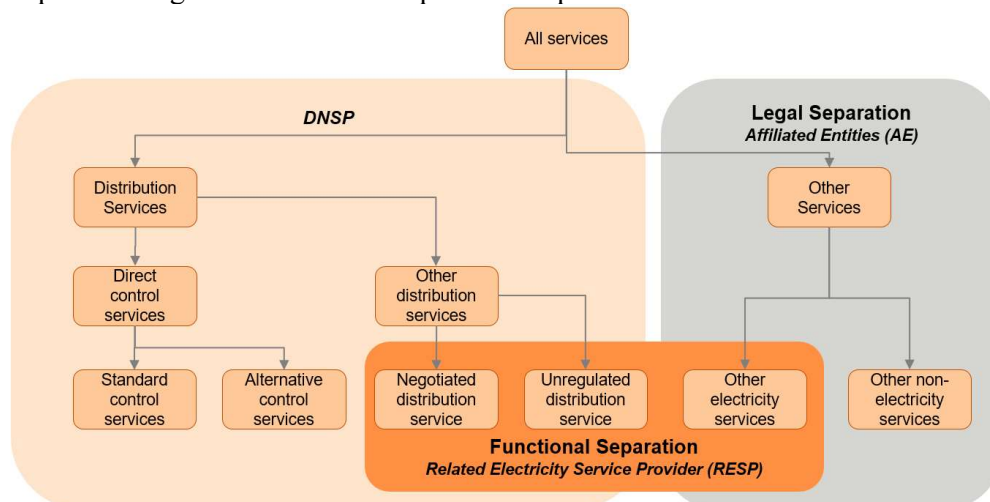
About the AER's Electricity Distribution Ring-fencing Guideline

Under rule changes associated with the AEMC's *Power of Choice* review, the AER was required to develop a ring-fencing guideline by 1 December 2016. The Guideline superseded NEM jurisdictional ring-fencing guidelines. These state-based ring-fencing guidelines were developed in the early-2000s and did not adequately account for new and emerging technologies (such as distributed solar PV and storage) or market reforms (such as the introduction of metering contestability). The AER Ring-fencing Guideline was updated in 2017 and distribution network service providers (DNSPs) were required to comply with the Guideline by 1 January 2018, with the exception of PWC. Since then we have been monitoring and enforcing compliance with the Guideline.

The AER Ring-fencing Guideline primarily targets two potential harms associated with DNSPs and their affiliates operating in markets for contestable services:

- Cross-subsidy of contestable services from a DNSP's regulated revenues.
- Discrimination by a DNSP in favour of an affiliate providing contestable electricity services.

The AER Guideline defines DNSP obligations according to services, not according to assets or business units. This is aligned with the broader framework for economic regulation of DNSPs under the NER, as we classify services provided by a DNSP as part of Distribution Determinations. In addition, we defined the term 'contestable electricity services' in the Guideline to cover all negotiated or unregulated electricity services. This expanded the scope of the Guideline beyond separation of retail and generation to separation of all contestable electricity services. The figure below provides an overview of how classification of services corresponds to legal and functional separation requirements in the Guideline.



The Guideline defines a compliance and reporting regime that includes annual reporting by DNSPs accompanied by an independent assessment of compliance by a third party. As noted in our Annual Compliance Report on the Electricity Distribution Ring-fencing Guideline 2017-18,¹ we have found independent assessor reports to be an important source of

¹ AER, *Annual Ring-fencing Compliance Report 2017-18*, March 2019, <https://www.aer.gov.au/system/files/Annual%20Report%20Final.pdf>.

transparency for the ring-fencing regime overall, and a useful tool in identifying compliance issues or the likely risk of non-compliance by DNSPs.

Further information on how the Guideline was developed is available in the Explanatory Statement to the version 1 of the Guideline.²

Application of AER Ring-fencing Guideline to Power and Water Corporation

We note that the Utilities Commission's issues paper poses questions associated with potential duplication of ring-fencing requirements and financial reporting, due to the adoption of ring-fencing, cost allocation, and RIN reporting requirements in the NER.

From 1 July 2019, a limited subset of obligations in the AER Ring-fencing Guideline will apply to PWC under clauses 6.17.1A and 6.17.1B of the NT NER. Under derogations in the NT NER, PWC is not required to provide 'other services' from a separate legal entity, nor is PWC required to functionally separate staff, offices and branding in order to provide contestable electricity services. PWC is required to comply with Guideline requirements relating to transaction reporting and separate accounting, but this is limited to 'related electricity services providers' (which provide contestable electricity services) only.

In developing the AER Ring-fencing Guideline we sought to leverage existing mechanisms for cost allocation, accounting and financial reporting in the regulatory framework to avoid duplication. Under the NER, PWC is required to develop a cost allocation methodology (CAM) according to the cost allocation principles in the NER, and submit annual RIN responses to the AER, including audited financial reporting. The AER Ring-fencing Guideline builds on these mechanisms by mandating legal separation of non-distribution services, which triggers certain accounting requirements. Our Guideline also strengthens the operation of the CAM, by requiring a DNSP to allocate and attribute costs as though the CAM otherwise applied to the allocation and attribution of costs between both distribution and non-distribution services.

We do not see any prima facie reason that the AER Ring-fencing Guideline could not apply to PWC in full at some point in the future. The AER Guideline allows for regional exemptions and waivers to accommodate special circumstances where there is overall benefit to customers from allowing DNSPs to provide contestable services. However, we realise that PWC is unique in that it operates smaller stand-alone networks, and that contestability of services in the Northern Territory is different to the rest of the NEM.

² AER, *Electricity distribution ring-fencing guideline – Explanatory statement*, November 2016, <https://www.aer.gov.au/system/files/AER%20Ring-fencing%20Guideline%20-%20Explanatory%20statement%20-%2030%20November%202016.pdf>.