



**SUBMISSION ON "ELECTRICITY
DISTRIBUTION: RING FENCING
GUIDELINES"**

1.0 Introduction

We refer to the Consultation Paper *“Electricity Distribution: Ring-Fencing Guidelines”* (“the Paper”) issued by the Queensland Competition Authority (“QCA”) for comment by 10 March 2000. We welcome the opportunity to comment and ask that you accept this as a submission on behalf of both Ergon Energy Corporation Limited (“EECL”) and Ergon Energy Pty Ltd (“EEPL”) (collectively referred to as “Ergon Energy”) to this aspect of the consultation process.

Ergon Energy’s submission is divided into two sections:

- The first deals with issues of concern arising from Parts 1 to 6 of the Paper and is largely focused on the QCA’s approach to ring-fencing and the issues it is obliged to consider under the National Electricity Code (“the Code”) in formulating the ring-fencing guidelines (“the Guidelines”).
- The second is an analysis of and comment on the Guidelines themselves contained in Attachment A of the Paper.

Ergon Energy will, of course, give consideration to further comment as part of any subsequent consultation process.

2.0 General Comment

Without reiterating the matters raised in our submission to the Issues Paper *“Ring Fencing for Electricity Distribution Entities”* under cover of our letter to the QCA of 20 August 1999, Ergon Energy maintains that it is not possible to divorce industry structure (and its appropriateness) from a consideration of the Guidelines and the regime that the Guidelines represent. Where relevant in this submission, we have relied on the comments that have been previously made to the QCA on this issue, a number of which have since been noted in the Paper.

3.0 “Consistency”

The QCA has stated its intention to ensure that, as far as possible, the Guidelines are consistent with the approach taken by other jurisdictions in formulating similar ring-fencing requirements and has utilised the Gas Code as a template for ring-fencing in electricity.

Ergon Energy accepts the obligation to consider “consistency” imposed on the QCA by section 6.20.2(d) of the Code and agrees that consistency, where possible, is desirable as an objective. Ergon Energy is however concerned that:

- The Paper contains a statement by the QCA that *“in the near future, legal separation will be introduced at the national level in transmission, as well as in New South Wales at the distribution level”*. No evidence is provided by the QCA to support these assumptions and Ergon Energy is not aware of any evidence other than discussion or anecdotal evidence of this occurring.

Ergon Energy’s concern is that these “suggested” changes to ring-fencing in other jurisdictions have been given considerable “weight” by the QCA in its formulation of the Guidelines, although adoption of this position in other States

has yet to occur. It is suggested that a consideration of “consistency” as required under the Code should result in an apportionment of an appropriate degree of weight to the fact that legal ring-fencing does not exist in these jurisdictions, rather than an apportionment of weight to the fact that legal separation may be adopted.

Ergon Energy supports QCA’s suggestion of ongoing liaison between regulatory bodies with a view to ensuring greater consistency over the medium term.

- Under the Guidelines and in a comparison between jurisdictions, Ergon Energy (as a Queensland based entity) is operating under an imposed structure that places it at a competitive disadvantage to competitors based in other jurisdictions. This not only increases the regulatory risk faced by Ergon Energy but also stifles its ability to innovate with products and services. Queensland electricity entities should be afforded the same options for asset ownership and operation as other Jurisdictions.

For example, Ergon Energy operates isolated generators as part of our distribution role. Although these isolated networks are outside the scope of the Code, the QCA should seek to ensure that the Guidelines do not adversely impact the provision of electricity to isolated customers. Concern is expressed that the definition of “related business” could result in this occurring. In addition, embedded generators can be an economic alternative to system augmentation in specific circumstances. Ergon Energy should not be precluded from taking a financial position in an embedded generator in such a circumstance.

- There are a number of concepts that do not comfortably transfer from other jurisdictions to the Queensland industry and accordingly, there is a need to recognise these differences to avoid an inappropriate or forced interpretation of the Guidelines for Queensland’s purposes in their subsequent interpretation.

Essentially, Ergon Energy’s concern is the parity of treatment across Jurisdictions. It is suggested that an assessment of “consistency” between jurisdictions discloses a less stringent treatment of ring-fencing in other States than that adopted under the Guidelines in Queensland.

It is further suggested that a set of benchmark ownership rules are preferable to specific and preclusionary provisions which limit the ability of entities to form natural hedges and economic efficiencies through a range of energy related activities. A regulatory control in the form of the Australian Consumer and Competition Commission (“the ACCC”) exists to provide an oversight role in instances where there is concern that an activity or an acquisition will constitute a misuse of market power or undue market control. The ACCC’s role will deliver a market driven approach in favour of a prescribed regulatory framework that limits both competition and allocative efficiency improvements as may result from the QCA’s approach.

4.0 Structure

Although Ergon Energy largely agrees with the QCA’s interpretation of current industry arrangements in Queensland, there are inaccuracies in the Paper that should be rectified and the impact of these amendments on the QCA’s determination assessed:

- The QCA’s definition of “*related business*” refers to a prohibition on distributors from “engaging” in businesses associated with a number of specified activities relating to electricity. In defining “related business” the QCA does not appear to acknowledge the subsidiary nature of the retail operations of the distribution entities.

Therefore, although ring-fenced both functionally and for accounting purposes, the 100% “ownership” of the retail arm could conceivably fall within the prohibition contained in the definition and resulting in the carrying on of a “related business”. It is suggested that the terminology used in the definition should be amended to reflect a prohibition on the carrying on of a related business within the entity.

- There is an incorrect reference to EEPL being established as a “*company Government Owned Corporation [“GOC”] under the Corporations Law*”.

Although it is correct that EEPL is a company established under the Corporations Law, it is under the *Government Owned Corporations Act 1993* and associated Regulations that EEPL is deemed to be a “subsidiary GOC company” for the purposes of the GOC Act.

By implication, EEPL’s obligations under Schedule 4 of the GOC Act result in financial separation of Ergon Energy’s business operations. It is therefore not correct to state in the Paper that the only legislative or regulatory requirement to separate retailing entities from their parent entities is under the normal reporting requirements of the Corporations Law. The extensive requirements of the GOC Act also apply.

This distinction and the classification of EEPL is also important when it is necessary to consider the process required to be followed by EECL and EEPL in ensuring that the Guidelines are complied with. The implication of this is discussed further below under point 5 below.

5.0 Degree of Structural Integration

There are a number of comments contained in the Paper that “*the Authority notes that the costs of ring-fencing are likely to be significantly higher where an integrated structure is adopted, relative to those that would be incurred under a structure which had greater structural separation*”. The QCA has further stated in the Paper that “*these costs should be borne by the entities being regulated*”. While acknowledging that ring-fencing is an inherently intrusive activity, the QCA expresses the view that “*the greater the upfront requirements for formal separation of activities, the lower the ongoing intrusiveness of regulation is likely to be*”.

Ergon Energy appreciates the QCA’s consideration of the costs and disruption to business that will flow from operation of the Guidelines however, disagrees with the QCA’s view that stringent upfront requirements equate to less ongoing intrusiveness of regulation for the following reasons:

- Ergon Energy is already exposed to a significant amount of regulation that governs its respective distribution and retail activities. It is not the case that, outside of the Guidelines, Ergon Energy is able to undertake any business activity that it chooses.

- Both EECL and EEPL have restrictive objects in their Constitutions that already place both companies at a competitive disadvantage with electricity entities in other States in their inability pursue complementary/ancillary businesses.
- Legal separation results in both entities reporting on their activities, as would any other entity incorporated under the Corporations Law. In addition, both entities report annually to State Parliament.
- The terms of the GOC Act restrict both entities in the manner in which they would be able to undertake any form of restructuring or transfer of assets. Both Entities are further restricted in their operations by extensive regulation under the Electricity Act.

The combination of these restrictions means that it is inappropriate to suggest that the costs and business disruption associated with ring-fencing and application of the Guidelines can be met or reduced through Ergon Energy adopting a greater degree of formal separation or altering its current established structure.

Bearing in mind the QCA's role in ensuring competitive neutrality in the franchise electricity market in Queensland, Ergon Energy expresses its concern to the QCA that the costs associated with greater structural separation for electricity entities in Queensland will exacerbate the competitive disadvantage that Ergon Energy experiences in relation to electricity entities in other States that are less regulated than Queensland and who are permitted to have a more flexible corporate structure.

6.0 Aspects of ring-fencing raised in the NEM

Legal Separation

As stated above, Ergon Energy is of the view that the existing legal separation between EECL and EEPL ensures that the information flows between them are quarantined in a manner that is not seen in other jurisdictions and facilitates application of the non-discriminatory access provisions of the Code.

We note the comment contained in the Paper that the QCA is of the view that there may be additional contestable elements within a distribution business that should be separated. Ergon Energy would oppose any suggestion that a separate legal entity should be established for this purpose. For the reasons outlined in our original submission to the QCA on this issue, the scope and level of provision of service to Ergon Energy customers can only be economically achieved through appropriate accounting separation in a single business. This is a key issue in regional Queensland where it is neither economic nor practical to separate service delivery based upon prescribed/non-prescribed boundaries.

We are however encouraged by the indication in the Paper that the QCA concerns may be addressed by separate reporting on the non-regulated aspects of the businesses.

Accounting Separation

Ergon Energy agrees that the additional requirements proposed by the QCA (compliance reports, separate sets of accounts and the auditing of those accounts) appear reasonable.

Cost Allocation

Ergon Energy agrees in principle with the prohibition of cross subsidisation between prescribed services and any other services provided and that cost allocation should be undertaken in a fair and reasonable manner. Guidance is requested from the QCA however as to when, how and in what format it will require the submission of the cost allocation methodologies and the process for approval.

Although in general agreement with this as a suggested means of satisfying the QCA on the issue of cost allocation, Ergon Energy reserves its right to make further comment at such time as it has had the opportunity to assess the process proposed.

Limits on Information Flows

Ergon Energy queries a number of the statements made by the QCA in the Paper on the issue of limitations to information flow and in particular:

- The QCA has stated that a retailer can receive an enhanced ability to manage risk through load switching. In competitive markets, load curtailment is undertaken for commercial gain. Networks become involved in contestable load curtailment due to the physical need for the temporary disconnection of supply and the impact of load variation upon the network itself. In franchise markets within Queensland, load curtailment (whether hot water or otherwise), is managed to ensure the CSO obligations are minimised and the network investment is able to be optimised due to demand smoothing.

Neither of these instances constitute an inappropriate exchange of information.

- A further concern was expressed in relation to the treatment of customer information and the basis upon which this should be available if there is a legitimate commercial need. It is submitted that the proposals put forward by the QCA in relation to this already occur within Ergon Energy.
- Comments have been made as to the degree of common staffing between distribution and retail entities, particularly in the area of Board membership. With respect, Board membership is not an issue that is within the control of the individual entities as the Government determines the composition of the Boards.

In addition, it is common commercial practice for joint Board membership between a corporation and its subsidiary. QCA's suggestion that this not occur defies common business practice.

7.0 Guidelines –Attachment A

We have attached to this submission a document that follows the format of the Guidelines issues with the Paper as Attachment A. Where relevant, we have made comments on the Guidelines under the obligations and in the order that they appear in the Paper.

8.0 Conclusion

Ergon Energy is of the view that significant levels of ring-fencing currently exist in Queensland due to the structure of the industry and existing regulatory requirements. The Guidelines should take account of these existing requirements and the structure and commercial freedom allowed of competitors in other States. We would welcome the opportunity to discuss this submission and in particular, the implications of the connection between structure of the industry within Queensland, structure of the industry in other States and the Guidelines.

We thank the QCA for the opportunity to submit on the draft Guidelines and would appreciate the ability to participate in any further consultation process.