



***Submission
to the
Queensland Competition Authority
(QCA)***

***ELECTRICITY DISTRIBUTION:
RING FENCING
GUIDELINES***

Submission by ENERGEX Limited

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INTRODUCTION

This paper is a submission made to the Queensland Competition Authority (QCA) in response to its Draft Paper *Electricity Distribution: Ring Fencing Guidelines* dated December 1999. The paper invites comments from interested parties on the draft to be made as part of a consultative process for the regulation of the electricity industry as required under the National Electricity Code.

ENERGEX Limited ("ENERGEX") is making this submission on behalf of all subsidiaries including ENERGEX Retail Pty Ltd.

The approach used in this submission is to address, in turn, each chapter and any issues raised in the paper. ENERGEX has reviewed the QCA Issues Paper *Electricity Conduct Rules* prior to making this submission. Comments made in this submission are made in mind of the Conduct Rules paper but ENERGEX will make a separate submission on this paper in due course. Comments made in this submission may be made public as part of the normal consultation process by QCA.

ENERGEX submits that regulation should be light-handed to avoid unnecessary intervention in an industry that is rapidly becoming contestable. Rules should only be prescribed where there are clearly demonstrable benefits exceeding the costs of regulation.

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COMMENTS:

CHAPTER 1: OVERVIEW

The QCA paper highlights several key issues as follows:

- *A key principle is to minimise the cost and intrusiveness of the exercise to the distribution entities. A further principle is to require a cost-benefit analysis for each ring fencing requirement.*
- *The National Electricity Code (NEC) requires consistency with the National Third Party Access Code for Natural Pipeline Systems (the Gas Code) and has used the Gas Code as a template for ring fencing in electricity.*
- *The proposed approach is consistent with other jurisdictions, especially Independent Pricing and regulatory Tribunal (IPART).*

It is the view of ENERGEX that the above principles indicate some inconsistency in approach by the QCA.

We accept and endorse the principle that the costs and intrusiveness of ring fencing should be limited. However, as stated in our earlier submission to the QCA's Issues Paper (July 1999), we believe that the Queensland arrangements already impose costs far in excess of those of our interstate counterparts. For example, in both NSW and Victoria there is no structural separation and this results in far lower costs. ENERGEX has separate Boards, CEOs, executive teams and premises and these costs already place us at a competitive disadvantage. Therefore, further prescription in Queensland will create a greater inconsistency compared to other jurisdictions, particularly if the Gas Code is used as the model. We also note that the QCA suggests that IPART will be using a similar approach to ring-fencing to that proposed by QCA. We are unaware of any public comment to this effect, as the current arrangements in NSW do not include legal separation.

We accept the benefits of using the same arrangements as other jurisdictions, however as stated above we already exceed the requirements of NSW and Victoria. Indeed, the adoption of the Gas Code as the fundamental model of ring fencing is believed to be inappropriate. The National Electricity Code (NEC) makes no mention of the Gas Code and we find that the logic used in selecting the Gas Code is somewhat puzzling. Section 6.20.2d3 of the NEC raises the requirement for each Jurisdictional Regulator to consider the ring fencing requirements of other utility businesses. Why not choose rail, telecommunications, ports or electricity as applied elsewhere as the model rather than gas? Further, it is our understanding that the panel who developed the ring fencing section of the NEC deliberately did not utilise the Gas Code because of the extent of its prescription and the difficulties it would impose on the various jurisdictions in its application due to issues of current business structure.

ENERGEX is now a multi-utility selling both gas and electricity. This is a trend that will undoubtedly continue with companies like ENERGEX venturing into utility businesses other than electricity eg. telecommunications, gas, water. From this arises a difficulty in that multiple forms of regulation could exist within a single business. We contend that legal separation and legal provisions such as the GOC Act, TPA provisions and Competitive Neutrality Laws should be utilised rather than complex and intrusive arrangements specific to one type of utility.

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ENERGEX submits that the use of a mechanism such as that described in the Gas Code would only be appropriate if it was universally applied across jurisdictions and across all types of utilities. Otherwise the QCA's key principles regarding cost imposition and consistency between jurisdictions cannot be achieved.

We believe that a better approach is to rely on existing legal separation and the framework of legislation as currently exists that guards against anti-competitive conduct.

CHAPTER 2: CURRENT ARRANGEMENTS IN QUEENSLAND

The QCA identifies that the retailing functions are significantly integrated with the day to day operations of the distributor especially with an overlap of staff and senior management.

This is not so for ENERGEX. The distributor is geographically, operationally and financially removed from the retailer. There are separate Boards, separate CEOs, separate management teams and separate offices. Indeed, even some of the "common" functions that could be arguably best managed in a single office such as regulatory affairs, have been deliberately separated to remove any concerns about inappropriate outcomes.

There are some shared services and it is appropriate for these to remain shared with some form of cost allocation applied between distribution and retail functions. A good example is our call centre that is used to process enquiries for both network and retail functions. We believe that it is appropriate for the call centre to remain a shared facility for the following reasons:-

- such a service could be contracted to a third party who could be carrying out similar activities for a number of businesses and such a facility would be subject to the general trade practices laws, as is our facility;
- shared call centres have been permitted in other jurisdictions; and
- we believe that it is in the public benefit to retain such a shared facility. If we are forced to introduce separate facilities this would increase costs without providing demonstrated benefits.

ENERGEX submits that retailing functions are not integrated with the day to day operations of the distributor.

CHAPTER 3: THE ROLE OF THE AUTHORITY

No comment.

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CHAPTER 4: OBJECTIVES AND PRINCIPLES

The QCA identifies as key objectives the establishment of a fair and truly competitive market and clear definitions of what are prescribed services.

ENERGEX would not support the separation of distribution services from contestable functions unless the advantages of allowing new competitors in the contestable market to compete on a fair basis outweighs the costs of imposing the ring fencing restraints. It is our view that a competitive market does exist in regard to customer contestability and retailing. We are unaware of any concerns that exist in the market in relation to information flows, contestability / market transfer processes or network pricing related matters.

ENERGEX submits that there is no need for services to be prescribed where there is a functioning contestable market for provision of such services.

For example, the market in contestable metering for Tranches 1, 2 and 3 means that this need not be prescribed.

Where the market is still developing, and especially where there is considered to be an obligation for someone to provide the service, then services probably need to be prescribed. ENERGEX would like to work with the QCA on clarifying prescribed services.

CHAPTER 5: ISSUES

The QCA suggests that the National Electricity Code specified consistency with the ACCC, other regulators and the Gas Code.

As commented earlier, the NEC code does not require consistency with the Gas Code.

The QCA notes that legal separation is already in place in Queensland. The industry structure is also taken as given. QCA is of the view that legal separation alone is inadequate to ensure that the sharing of information and costs is mitigated.

Separate accounting and reporting is already being undertaken by the distribution and retailing businesses. As noted in our submission to the QCA issues paper, ENERGEX is required to report separately due to its existing legal separation. Separated Accounts are audited by the Queensland Audit Office and this ensures that the accounts reflect a true and fair view of the individual entity results. In addition, quarterly reports are provided to Government shareholders as required by the GOC Act and GOC subsidiaries Act.

Further to this ENERGEX is also effectively regulated for ring fencing purposes by the Trade Practices Act (TPA) and Competitive Neutrality Laws. Under the TPA, practices such as contracts or covenants restricting competition, misuse of market power and exclusive dealing are prohibited. These laws relate to how distribution and retail businesses relate to competitors.

While we accept QCA's concerns about the sharing of information and costs we believe that the existing legal separation provides a level of assurance far in excess of that provided in other States. We believe that further controls are

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unnecessary and will impose significant costs on our business. These costs cannot be justified when considering the need for consistency across jurisdictions and the pre-existing cost advantage that utilities in other Jurisdictions enjoy due to their lack of legal separation.

We believe the QCA should define a series of principles about information flows and related issues. In our submission to the QCA's issues paper we noted support for the use of appropriate conduct rules in conjunction with the existing legal separation of the businesses.

ENERGEX submits that the existing legal separation and legislative framework including the TPA, and GOC Act provide adequate separation of distribution and retailing functions. The arrangements in place already exceed the requirements in other States and further complex and intrusive arrangements would add unnecessary costs.

The QCA prescribes an approach where distributors put forward their cost allocation methodologies for approval.

ENERGEX submits this is unnecessary given the basic structure and the separation of the retail and distribution businesses that has been in place for several years.

The QCA puts forward the view that one example of concern in regard to information flows is the current advantage that incumbent retailers enjoy regarding the knowledge about hot water switching patterns.

While this concern is noted, ENERGEX is extremely concerned about any move to limit the use of hot water to manage demand. The hot water load control system has been developed over many years to the advantage of customers throughout Queensland. Its use minimises costs in the distribution and transmission networks which flows through to customers as reduced TUOS and DUOS charges, as well as minimising pool price increases through energy trader activities.

In its Statement of Corporate Intent, NECA has listed one of its strategic imperatives as "promote a significantly greater degree of proactive demand-side participation in the market". We believe that any move that limits the use of hot water load in the market could impose serious risks on the integrity of the electricity supply arrangements in Queensland and be counter-productive with other initiatives under development within the National market.

The QCA proposes a system of exemptions if the ring fencing arrangements put in place would lead to additional, unwarranted costs.

ENERGEX supports a system where specific exemptions can be sought.

We believe that in some cases the proposed arrangements are unworkable. An example of this is where staff in a customer call centre may be considered to be marketing staff. If this was the case we believe that this would be a highly inappropriate outcome, given the subsequent need to introduce separate call centres for each business.

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The QCA notes that while common branding for distribution and retailing entities is accepted it will pay particular attention to the cost allocation of marketing activities since it believe that all market activities should be allocated to retail.

ENERGEX does not support the view that all marketing costs should be allocated to the retail business. There are legitimate branding and marketing costs associated with the regulated network business.

Marketing can occur for a range of reasons including safety and the appropriate use of electricity to manage demand. Further, we are being encouraged by the regulatory environment to provide appropriate signals to customers to ensure that networks are fully utilised. Therefore in some circumstances it is entirely appropriate for network businesses to carry out marketing. We would also note that joint marketing occurs for businesses in other States and would request that consistency of approach across jurisdictions is a key parameter in any decisions about this issue.

CHAPTER 6: THE AUTHORITY'S APPROACH

The previous comments about the use of the Gas Code are reiterated.

APPENDIX A: DRAFT RING FENCING GUIDELINES

Clause 1(i): The QCA prescribes that there be no common marketing staff between a retailer and a DNSP.

ENERGEX rejects this obligation. There are many better ways of ensuring choice of retailers, such as:

- agreed rules of conduct;
- Trade Practices restrictions on use of market power;
- Complaints process for abuse of market power.

ENERGEX understands and supports the regulatory objective of ensuring customers have a choice of retailer, rather than being restricted to the retailer associated with the DNSP. However, we believe that the prohibition of common marketing staff is unwarranted.

We believe that there are legitimate reasons why marketing is required for network businesses as stated above. Further, separation of staff in call centres, for example, will drive very significant cost increases without material benefit. We believe that appropriate competitive outcomes can be achieved through the use of conduct rules and the existing legislative framework. Again, comparison with the systems in place in other jurisdictions demonstrates that we already suffer a competitive disadvantage in this regard. Further prescription cannot be justified.

Clause 3: The QCA prescribes that the QCA must be notified if there are, or may be, common employees, consultants, independent contractors or agents between a retailer and a DNSP.

ENERGEX rejects this prescription. To comply with this obligation, a DNSP would need to monitor all contracts, such as accounting, legal and even matters such as cleaning, and notify the QCA of any commonality. This is impractical and would be very costly on both DNSPs and the QCA to implement.