

RING FENCING GUIDELINE

COMPLIANCE PLAN

AER Submission - July 2017



Purpose of this document

- > This document outlines Essential Energy's strategy to achieve compliance with the AER's Ring Fencing Guideline
- > This strategic approach to achieving compliance has been approved by the Board of Essential Energy
- > The compliance strategy is dependent on the outcomes sought via the reclassification of some services or approval of a number of identified waivers
- > As a result, Essential Energy's implementation plan should be viewed as a 'living' document that may require adjustments throughout the implementation process
- > Essential Energy plans to build customer awareness on our Ring Fencing strategy in a number of ways:
 - via the uploading of this document and other relevant material on Ring Fencing on the Essential Energy external website;
 - via the uploading of this document onto the AER website;
 - by incorporating the option of including Ring Fencing information in our customer awareness campaign for the Power of Choice program; and
 - through customer engagement on our draft Regulatory Proposal.

Strategic approach to compliance

- > There are several key points that need to be highlighted around Essential Energy's strategic approach to compliance with the Ring Fencing Guideline
- > Essential Energy only has a small number of contestable services that are not aggressively pursued or marketed and are mostly geographically dispersed
- > The cost of legal or functional separation were judged to outweigh the benefits of creating a legally or functionally separate business/es to continue delivering these services
- > Therefore, the strategic approach to compliance is aimed at avoiding the costs of legal and functional separation
- > As a result, most activities to achieve compliance revolve around reclassification of services as alternate control, discontinuing to offer services except in regional office exempt locations, seeking a waiver from Ring Fencing obligations or discontinuing to deliver services
- > The Essential Energy Board have indicated that they are concerned about a reduction in services offered to regional and remote communities across our footprint
- > As a result, where we had originally proposed discontinuing services in our footprint, we are currently finalising a revised compliance approach for some minor services for use only in those areas without a functioning competitive market to ensure remote customers continue to have access to services

Impact of strategic approach to compliance

- > As a result of the strategic approach to compliance adopted, Essential Energy is likely to avoid or minimise costs related to the following obligations*:
 - Legal separation
 - Functional separation:
 - Office separation (additional leasing costs, fitout costs, etc)
 - Staff separation (incl. assessment of position descriptions / union consultation, enterprise agreement impacts, relocation costs, etc)
 - Branding separation (or any costs related to requiring new brand/s, changing out branding on uniforms, vehicles, buildings, stationery, etc)
 - IT system costs
 - Costs related to the transfer of assets between legal entities
 - Changes to internal finance/accounting processes/reporting (i.e. payroll, transaction posting, asset transfers)
 - Ring fencing of electricity information
 - Amendments to contracts (novation, etc)

- > As a result, Essential Energy does not expect to require a pass through application

* Subject to approval of waivers and reclassification of some services

Overview of ring fencing

- > The objective of ring fencing is to provide a level playing field for third party providers in new and existing markets for contestable services in order to promote competition in the provision of electricity services by removing the advantage DNSP's have as a regulated business
- > The aim of the Guideline is to address two risks:

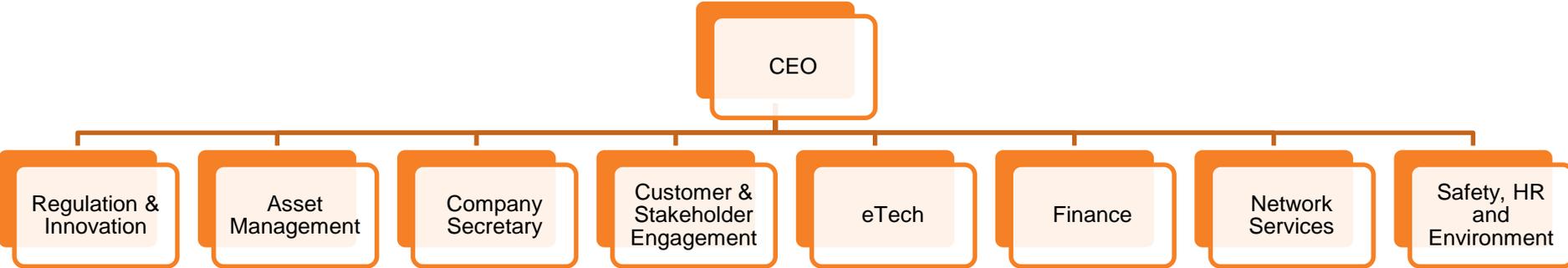
RISK	GUIDELINE'S RESPONSE
The risk of a DNSP cross-subsidising other services with revenue earned from provision of regulated services	Legal separation, separate accounts, extended Cost Allocation Methodology (CAM), report on related party transactions
The risk of a DNSP favouring its own or an affiliated entity's other distribution services or other electricity services in contestable markets	Behaviour obligations and functional separation (restrictions on office sharing and co-locating staff, information sharing and branding)

- > The ring fencing guideline imposes obligations on DNSP's to separate the legal, accounting and functional aspects of regulated distribution services from contestable services provided by a DNSP or affiliated entity
- > There are four key components of the functional separation part of the Guideline:

Obligation not to discriminate	Information access and disclosure
Separation of offices, staff, branding & promotions	Obligations with regards to new agreements with service providers

Essential Energy's organisational structure

- > Essential Energy is 100% owned by the NSW State Government
- > Essential Energy has no affiliated entities
- > Essential Energy's organisational structure is shown below:



Process to develop strategy

- > The following process has been followed to develop Essential Energy's strategy to gain full compliance with the Guideline:

Detailed review of all services provided by Essential Energy

Expert advice sought on the classification of each service

Development of a compliance gap analysis

Development of an options assessment

Development of an implementation plan

Executive and Board approval of the strategy for achieving full compliance

Service identification and classification

- > The detailed review of the services offered by Essential Energy (other than standard control and alternative control services) highlighted the following:

Service	Classification under the Guideline and current classification of services 2014-19
Essential Water	Other non-electricity service
Water Access Agreement – Clarence Valley Council	Other non-electricity service
Recoverable Works / Contestable Works	Unclassified distribution service
Technical Training	Unclassified distribution service
Contestable Metering	Unclassified distribution service
Nightvision	Unclassified distribution service
LED Streetlights	Unclassified distribution service
Generation	Other electricity service
Shared Asset Services*	Unclassified distribution service
Sale of Stock to ASP's	Unclassified distribution service
Sale of Scrap / Sale of Obsolete Inventory	Unclassified distribution service

*Shared Asset Services are: fibre optic rental, property rental, radio site rental, NBN/Optus

Compliance gap identification

- > A compliance gap assessment was conducted on each service based on the classification of each service under the current 2014-19 classification of services
- > Potential compliance issues were identified across most of the identified services – for example:
 - services identified as other non-electricity services or other electricity services with regards to legal separation; and
 - services identified as unclassified distribution services with regards to functional separation
- > For the purpose of the compliance assessment, for those functional separation clauses where an exemption exists a three part test was established to determine whether these would apply to each service:
 1. Is there competition or potential competition in this service? If no – exempt. If yes, go to step 2;
 2. Would staff conducting this service have access to information which could be of commercial value? If no – exempt; if yes, go to step 3;
 3. Would staff have the opportunity to use that information in a discriminatory manner? If no – exempt; if yes 0 compliance issue
- > Additional compliance issues were identified relating to non-service based requirements (for example CAM and procedures covering accounting separation, information sharing protocol, registers, etc)

Options assessment

- > Following identification of compliance gaps an options assessment was undertaken for all identified gaps

- > Possible options identified, depending on the service and compliance gap, included:
 - Implement appropriate legal, staff, location and brand separation
 - Seek reclassification of service as an alternate control service
 - Utilise the regional office exemption for delivery of the service
 - Discontinue the service
 - Seek a waiver from the Ring Fencing obligations

- > In addition to compliance gaps where there were different options available there were a number of compliance gaps where action was mandatory, for example:
 - Establishing and maintaining appropriate internal procedures for accounting separation
 - Register of waivers
 - Register of exempt offices / staff

- > A draft implementation plan was drafted based on the agreed executive approach

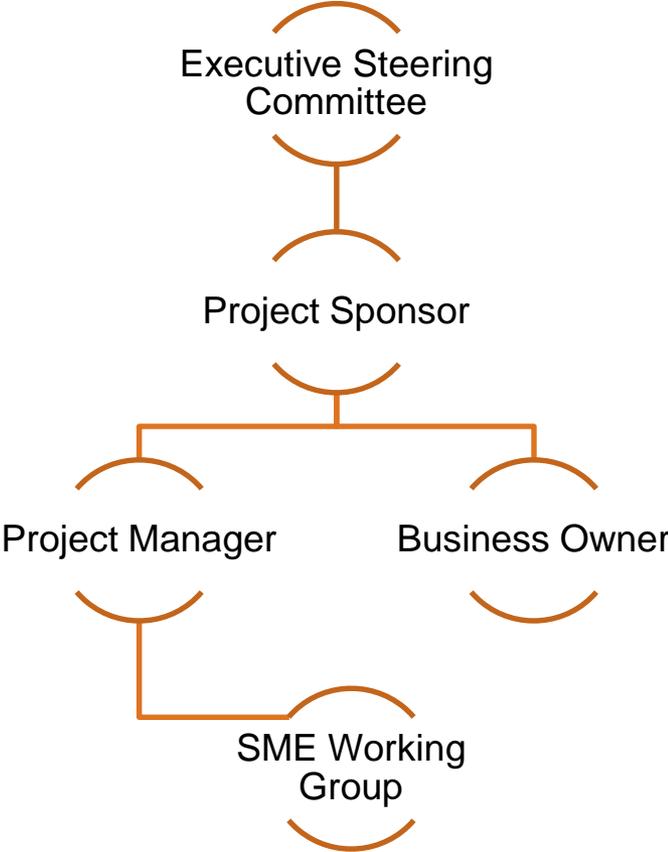
Strategic compliance approach

- > The service identification, compliance gap analysis and options assessment was presented to the executive and proposed approaches for each service debated
- > Proposed approaches to achieve compliance for each service was agreed
- > The strategic approach to achieving compliance was submitted to, and endorsed by, the Essential Energy Board

RING FENCING IMPLEMENTATION PLAN

Implementation governance

> Implementation of the Ring Fencing Guideline will be managed under the following structure:



HIGH LEVEL IMPLEMENTATION TIMEFRAMES

Work streams	Key activities	CY2017									CY 2018	
		Q2			Q3			Q4			Q1	
		Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Jan	
A. Compliance Strategy & AER submission	✓ Strategic direction on ring fencing compliance strategy and services that EE will pursue	█										
	✓ Submit draft compliance strategy to the AER		█									
	✓ AER provides informal feedback on compliance strategy			█								
	✓ Internal approval for final compliance strategy			█								
	✓ Submit formal compliance strategy to the AER				█							
B. Setting up Program Team	✓ Establish ring-fencing compliance Program Team			█								
C. Re-classification of Services	✓ Confirm services to be re-classified & develop strategy	█										
	✓ Consultation with AER (as part of Regulatory Reset Process)		█	█								
	✓ F&A paper published (AER)				█							
D. Waiver Application	✓ Determine strategy	█	█									
	✓ Prepare waiver applications and submit waiver		█	█	█							
	✓ AER publishes draft waiver decisions					█						
	✓ AER publishes final waiver decisions							█				
E1. Compliance – New Information & Reporting	✓ Separate accounts				█	█	█					
	✓ Cost allocation and attribution				█	█						
	✓ Office and staff registers, waiver registers								█	█		
	✓ Information sharing protocol				█							
	✓ Annual ring-fencing compliance report – process & audit							█				
E2. Compliance – Internal Procedures	✓ Framework on interactions between regulated staff and staff employed in contestable ASP service				█	█						
	✓ Framework for complying with conduct of service provider for new or varied agreement				█							
	✓ Process for dealing with breaches				█	█						
	✓ Training to all relevant staff including field staff						█	█				
	✓ Compliance plan & audit						█					
F. Legal & Functional Separation	✓ Separation and protection of confidential information (assuming no legal, office or staff separation required)				█	█	█	█				
G. Completion	✓ Review compliance achieved and undertake implementation close out activities										█	
	✓ Ring-fencing compliance required by AER											█

SERVICE-BY-SERVICE COMPLIANCE REVIEW AND APPROACHES TO ACHIEVE COMPLIANCE

SERVICE: ESSENTIAL WATER

Legal Separation Compliance?	Functional Separation Three Part Test			Functional Separation Compliance?	POTENTIAL OVERALL NON-COMPLIANCE?
	Is there competition in this service?	Would staff performing this service have access to information of commercial value?	Would staff have the opportunity to use this information in a discriminatory manner?		
OPTIONS TO ACHIEVE COMPLIANCE	<ul style="list-style-type: none"> • Legally separate Water business • Seek waiver as already regulated by IPART 				
APPROACH TO ACHIEVE COMPLIANCE	Seek waiver from legal separation as costs to achieve compliance outweigh benefits				

 = Potential Non-Compliance
 = Compliance

SERVICE: WATER ACCESS AGREEMENT – CLARENCE VALLEY COUNCIL

Legal Separation Compliance?	Functional Separation Three Part Test			Functional Separation Compliance?	POTENTIAL OVERALL NON-COMPLIANCE?
	Is there competition in this service?	Would staff performing this service have access to information of commercial value?	Would staff have the opportunity to use this information in a discriminatory manner?		
OPTIONS TO ACHIEVE COMPLIANCE	<ul style="list-style-type: none"> • Legally separate Water Access Agreement • Seek waiver as not a competitive service and no value in incurring separation costs 				
APPROACH TO ACHIEVE COMPLIANCE	Seek waiver from legal separation				

 = Potential Non-Compliance
 = Compliance

SERVICE: CONTESTABLE WORKS / RECOVERABLE WORKS

Legal Separation Compliance?	Functional Separation Three Part Test			Functional Separation Compliance?	POTENTIAL OVERALL NON-COMPLIANCE?
	Is there competition in this service?	Would staff performing this service have access to information of commercial value?	Would staff have the opportunity to use this information in a discriminatory manner?		
OPTIONS TO ACHIEVE COMPLIANCE	<ol style="list-style-type: none"> 1. Implement appropriate office, staff and brand separation 2. Utilise regional office exemption and discontinue service in non-exempt locations 3. Seek reclassification as alternative control service (provider of last resort) 4. Discontinue service across whole footprint 				
APPROACH TO ACHIEVE COMPLIANCE	<p>Essential Energy has decided to discontinue the service across our footprint. However, Essential Energy is concerned for those customers in locations where there is no competition and would like to be able to offer minor recoverable works services in these situations to ensure customers continue to have access to these services. We are currently finalising our compliance approach for these minor services. Our final approach may require the need for a future waiver to be submitted.</p>				

 = Potential Non-Compliance
 = Compliance

SERVICE: TECHNICAL TRAINING

Legal Separation Compliance?	Functional Separation Three Part Test			Functional Separation Compliance?	POTENTIAL OVERALL NON-COMPLIANCE?
	Is there competition in this service?	Would staff performing this service have access to information of commercial value?	Would staff have the opportunity to use this information in a discriminatory manner?		
RED - if conducting training outside our footprint					
OPTIONS TO ACHIEVE COMPLIANCE	<ol style="list-style-type: none"> 1. Implement appropriate office, staff and brand separation 2. Seek a waiver (unlikely to be granted) 3. Utilise regional office exemption and discontinue service in non-exempt locations and outside of footprint 4. Seek reclassification as alternative control service and discontinue outside of footprint 5. Discontinue service 				
APPROACH TO ACHIEVE COMPLIANCE	<ul style="list-style-type: none"> • Seek classification as an alternate control service where it is a monopoly training service • Discontinue contestable training services across our footprint. However, Essential Energy is concerned for those customers in locations where there is no competition and would like to be able to offer technical training services in these situations to ensure customers continue to have access to these services. We are currently finalising our compliance approach for these contestable technical training services. Our final approach may require the need for a future waiver to be submitted. 				

 = Potential Non-Compliance
 = Compliance

SERVICE: RESIDUAL CONTESTABLE METERING SERVICES

Legal Separation Compliance?	Functional Separation Three Part Test			Functional Separation Compliance?	POTENTIAL OVERALL NON-COMPLIANCE?
	Is there competition in this service?	Would staff performing this service have access to information of commercial value?	Would staff have the opportunity to use this information in a discriminatory manner?		
OPTIONS TO ACHIEVE COMPLIANCE	Seek a waiver based on covering current meters only with Essential Energy looking to exit the market and awaiting retailer action to churn remaining meters				
APPROACH TO ACHIEVE COMPLIANCE	Seek temporary waiver from functional separation until 30 June, 2019 to give retailers time to churn remaining meters				

 = Potential Non-Compliance
 = Compliance

SERVICE: NIGHTVISION

Legal Separation Compliance?	Functional Separation Three Part Test			Functional Separation Compliance?	POTENTIAL OVERALL NON-COMPLIANCE?
	Is there competition in this service?	Would staff performing this service have access to information of commercial value?	Would staff have the opportunity to use this information in a discriminatory manner?		
OPTIONS TO ACHIEVE COMPLIANCE	<ol style="list-style-type: none"> 1. Implement appropriate office, staff and brand separation 2. Seek a waiver from functional separation (unlikely to be granted) 3. Utilise regional office exemption and discontinue service in non-exempt locations 4. Seek reclassification as alternative control service (provider of last resort) 5. Discontinue service 				
APPROACH TO ACHIEVE COMPLIANCE	Seek reclassification as an alternative control service and seek interim waiver to cover until 1 July 2019				

 = Potential Non-Compliance
 = Compliance

SERVICE: LED STREETLIGHTS

Legal Separation Compliance?	Functional Separation Three Part Test			Functional Separation Compliance?	POTENTIAL OVERALL NON-COMPLIANCE?
	Is there competition in this service?	Would staff performing this service have access to information of commercial value?	Would staff have the opportunity to use this information in a discriminatory manner?		
OPTIONS TO ACHIEVE COMPLIANCE	Seek reclassification as an alternative control service and seek interim waiver to cover until 1 July 2019				
APPROACH TO ACHIEVE COMPLIANCE	Seek reclassification as an alternative control service and seek interim waiver to cover until 1 July 2019				

 = Potential Non-Compliance
 = Compliance

SERVICE: SALE OF STOCK TO ASP'S

Legal Separation Compliance?	Functional Separation Three Part Test			Functional Separation Compliance?	POTENTIAL OVERALL NON-COMPLIANCE?
	Is there competition in this service?	Would staff performing this service have access to information of commercial value?	Would staff have the opportunity to use this information in a discriminatory manner?		
	Limited				
OPTIONS TO ACHIEVE COMPLIANCE	Seek reclassification as an alternative control service and seek interim waiver to cover until 1 July 2019				
APPROACH TO ACHIEVE COMPLIANCE	Seek reclassification as an alternative control service and seek interim waiver to cover until 1 July 2019				

 = Potential Non-Compliance
 = Compliance

Refer to slide 9 regarding details of the Functional Separation Three Part Test



THERE ARE A NUMBER OF SERVICES WITH NO FURTHER ACTION REQUIRED:

SERVICES:	Legal Separation Compliance?	Functional Separation Three Part Test			Functional Separation Compliance?	POTENTIAL OVERALL NON-COMPLIANCE?
		Is there competition in this service?	Would staff performing this service have access to information of commercial value?	Would staff have the opportunity to use this information in a discriminatory manner?		
Generation	OK as no income being generated	Yes but generators not currently operating	No as generators not currently operating	No		
Shared Asset Services*		Very limited	No	No		
Sale of Scrap	To be included as other income within standard control services – therefore, no compliance issues					
PROPOSED APPROACH TO ACHIEVE COMPLIANCE	No further action required – already compliant					
AER INFORMAL FEEDBACK	Agree with Essential Energy proposed approach					

 = Potential Non-Compliance
 = Compliance

*Shared Asset Services are: fibre optic rental, property rental, radio site rental, NBN/Optus