



Draft Decision

SA Power Networks application for waiver from the Electricity Distribution Ring-fencing Guideline

May 2017

© Commonwealth of Australia 2017

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the Director, Corporate Communications
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601
or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Mr Chris Pattas
General Manager, Networks
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Tel: 1300 585165

Email: ringfencing@aer.gov.au
AER Reference: 61887

Contents

Shortened forms	iv
Request for submissions	v
Summary.....	vi
1 AER Ring-fencing Guideline.....	1
1.1. Waiver process	1
2 SA Power Networks' waiver application.....	3
2.1. Energy security issues.....	3
2.2. South Australian Government's response	3
2.3. Obligations on SA Power Networks	4
2.4. Waiver sought by SA Power Networks	4
3 AER's draft decision and reasons.....	5
3.1. AER's draft decision.....	5
3.2. AER's reasons.....	5
3.2.1 Request for interim waiver.....	6
3.2.2 Scope of waiver.....	7
3.2.3 National Electricity Objective	7
3.2.4 Potential for cross-subsidisation and discrimination if the waiver is granted or refused	8
3.2.5 Balance of benefits and detriments from complying	9
3.2.6 Duration of the waiver	9

Shortened forms

Shortened form	Extended form
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
DNSP	Distribution network service provider
Guideline	Australian Energy Regulator, Electricity Distribution Ring-Fencing Guideline, November 2016
NEO	National Electricity Objective
SA Government	South Australian Government

Request for submissions

Interested parties are invited to make written submissions to the Australian Energy Regulator (**AER**) regarding this paper by the close of business, Friday **9 June 2017**.

Submissions should be sent electronically to: ringfencing@aer.gov.au.

Alternatively, submissions can be mailed to:

Mr Chris Pattas
General Manager, Networks
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information are requested to:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website at www.aer.gov.au. For further information regarding our use and disclosure of information provided to us, see the ACCC/AER Information Policy, June 2014 available on our website.

Enquiries about this paper, or about lodging submissions, should be directed to ringfencing@aer.gov.au.

Summary

On 27 April 2017, SA Power Networks applied to the AER for a waiver of the legal separation obligations listed in clause 3.1 and the functional separation obligations listed in clause 4 of the AER's Electricity Distribution Ring-fencing Guideline.

SA Power Networks seeks this waiver until 1 June 2020 to enable it to design, construct, commission, connect and operate 200MW of temporary generation from 1 December 2017, as requested by the South Australian Government. Without a waiver, SA Power Networks is likely to be in breach of the Guideline during this period.

The temporary generation would assist the SA Government to manage energy security risks facing energy consumers in South Australia until it has built its own permanent 250MW gas-fired electricity generator. SA Power Networks submits the temporary generation will be used solely for the purpose of avoiding load shedding for NEM operational purposes when there is no alternative generation available, and only at the direction of AEMO or the South Australian Energy Minister. The SA Government will bear all costs from the project and will also receive any market revenues from providing the generation. Once the 250MW generator is operational, SA Power Networks will decommission the temporary generation.

Clause 5.3.1 of the Guideline provides that the AER may waive a DNSP's obligations under clauses 3.1, 4.2 and/or 4.4.1(a) of the Guideline subject to any conditions the AER considers appropriate). In deciding whether to grant a waiver, we must have regard to the factors at clause 5.3.2 of the Guideline. The waiver sought by SA Power Networks relates to obligations regarding:

- legal separation
- physical separation, staff separation, branding and cross-promotion and office and staff registers, and
- ensuring that any new or varied agreement between the DNSP and a service provider requires that service provider to comply with the relevant clauses of the Guideline.

SA Power Networks requested the AER grant an interim waiver to enable it to meet the SA Government's target date for operation of the temporary generation of 1 December 2017. We are satisfied an interim waiver is not required because SA Power Networks is unlikely to be in breach of the Guideline until the temporary generators are operational. Instead, we consider that a standard waiver process is appropriate in this instance as this would permit time for consultation with stakeholders. Nevertheless, we are expediting our consultation process to assist SA Power Networks to enter into contracts and other arrangements necessary to progress the development of the temporary generation service by 1 December this year.

On the basis of SA Power Networks' application and information, including from the South Australian Government about the temporary generation project, our preliminary

view is to grant the waiver SA power Network is seeking. Granting the waiver is likely to advance the National Electricity Objective by providing greater reliability and security of electricity supply for South Australian electricity customers, until the permanent generation becomes operational.

The waiver only applies where the generation capacity is operated in the way specified by SA Power Networks in its application. That is:

- it is utilised for the purpose of avoiding load shedding for NEM operational purposes when there is no alternative generation available
- is only utilised at the direction of AEMO or the South Australian Energy Minister, and
- is fully funded by the SA Government, who also receives all revenues from the project.

If the generation capacity is operated in this way, the expected benefit is likely to outweigh any detriments from granting the waiver.

The AER proposes to grant SA Power Networks a waiver only:

- from its obligations under clauses 3.1, 4.2 and 4.4.1(a) of the Guideline
- in respect of the temporary generation project
- until 1 June 2020.

We now invite submissions in relation to this draft decision from interested parties for consideration in forming our final decision.

1 AER Ring-fencing Guideline

Ring-fencing separates the regulated and contestable parts of an electricity distribution network service provider's (**DNSP's**) network business via legal separation and functional separation obligations. Without ring-fencing, there is a risk that a DNSP might cross-subsidise unregulated electricity services with revenue earned from provision of distribution (and transmission) services. There is also a risk that a DNSP might discriminate in contestable markets in favour of its own negotiated service, other distribution services, or an affiliated entity's other electricity services. Such outcomes could lead to less efficient prices for operation and use of both regulated and contestable electricity services and restrict the development of competition in contestable markets.

In this way, ring-fencing aims to achieve the National Electricity Objective (**NEO**) of promoting efficient investment in, and efficient operation and use of, electricity services for the long-term interests of consumers of electricity with respect to price, quality, safety, reliability, and security of supply of electricity, and the reliability, safety and security of the national electricity system.

The AER published its Electricity Distribution Ring-fencing Guideline (the Guideline) on 30 November 2016. The Guideline became effective across the National Electricity Market (**NEM**) on 1 December 2016, replacing jurisdictional ring-fencing guidelines.¹ Each DNSP must comply with all of the obligations of the Guideline as soon as reasonably practical and by no later than 1 January 2018. The period from commencement of the Guideline until the compliance deadline is considered a transition period, during which DNSPs are expected to design and implement their compliance plans and engage with the AER on their progress.

1.1 Waiver process

Clause 5.2 of the Guideline states that a DNSP may apply in writing to the AER for a waiver of its obligations under clauses 3.1, 4.2 and / or 4.4.1(a) of the Guideline regarding:

- legal separation
- physical separation, staff separation, branding and cross-promotion and office and staff registers, and
- ensuring that any new or varied agreement between the DNSP and a service provider requires that service provider to comply with the relevant clauses of the Guideline.

A DNSP may apply on its own behalf or on behalf of itself and one or more other DNSPs who are affiliated entities of the DNSP.

Upon receiving a DNSP's waiver application, the AER will check that it contains all the information and materials necessary to support it, including in relation to the matters specified at clause 5.2 of the Guideline.

¹ Clause 6.17.1 of the National Electricity Rules obliges all DNSPs to comply with the Guideline.

If we consider the waiver application does not fully comply with clause 5.2, we will notify the DNSP within 10 business days of receiving the application. Upon receiving validly lodged application, we will commence the assessment process.

We will assess the application as directed by clause 5.3.2 of the Guideline and prepare a draft decision for consultation with interested parties, which we will publish at ww.aer.gov.au.

After the consultation period ends, we will publish a final decision on the waiver application, including the terms and conditions of any waiver we grant. We will endeavour to make a final decision on each waiver application within 90 days of valid lodgement.

In exceptional circumstances, we may modify this waiver process to the extent we consider appropriate and allowed by the Guideline.

In the event that a waiver is granted, the AER may, in its absolute discretion and at any time, vary or revoke a DNSP's waiver as long it has given the DNSP at least 40 days' notice that it is considering doing so.

Table 1: Timetable for assessing SA Power Networks' waiver application

Event	Date
Waiver application received from SA Power Networks	27 April 2017
AER's draft decision released, call for submissions	26 May 2017
Submissions on application and draft decision due	9 June 2017
Target release date for AER's final decision	21 June 2017

2 SA Power Networks' waiver application

On 27 April 2017, SA Power Networks submitted to the AER a waiver application under clause 5.2 of the Guideline. SA Power Networks submitted that a waiver is necessary to allow it to assist the SA Government to address energy security risks facing South Australian customers.

2.1 Energy security issues

Over the past year, a number of states have experienced ongoing energy security concerns, with unreliable electricity supply resulting in significant electricity shortages at times of high demand. South Australia experienced a state-wide power outage in September 2016 and more localised power outages in December 2016 and February 2017.

The SA Government has submitted that the withdrawal of the Hazelwood power station in Victoria has increased the risk of system security issues. It estimated there is a potential shortfall of up to 500MW of generation to meet peak demand on days of extreme heat during the 2018 and 2019 summer periods, or earlier.

2.2 South Australian Government's response

On 14 March 2017, the SA Government announced its Energy Plan² to improve reliability of energy supply across South Australia and make the state will more self-sufficient.

As part of the Energy Plan, the SA Government has announced construction of a 250MW gas-fired electricity generator. This plant is expected to become operational in December 2018. To manage energy security risks in the short term, the SA Government has requested that SA Power Networks design, construct, commission, connect and operate 200MW of temporary generation from 1 December 2017.

SA Power Networks submitted that the temporary generation will be used solely for the purpose of avoiding load shedding for NEM operational purposes when there is no alternative generation available, and only at the direction of AEMO or the South Australian Energy Minister. Once the SA Government's new 250MW plant is operational, SA Power Networks will decommission the temporary generation facilities.

SA Power Networks submitted that the SA Government has determined that SA Power Networks is best placed to undertake the temporary generation project within the required timeframe and at least cost. It submitted that the SA Government will bear all costs of the project and will also receive any market revenues from operating the temporary generation. The temporary generation will not be used to set the NEM pool price in South Australia. SA Power Networks will establish and maintain separate accounts and cost allocation and attribution to the temporary generation project to ensure the project can be funded transparently by the SA Government.

² See ourenergyplan.sa.gov.au

2.3 Obligations on SA Power Networks

The Guideline imposes obligations on SA Power Networks in relation to:

- legal separation
- establishing and maintaining accounts
- obligation not to discriminate
- separating offices, staff, branding and promotions
- information access and disclosure
- registers for offices, staff and waivers
- maintaining and reporting compliance, and
- transitional arrangements.

2.4 Waiver sought by SA Power Networks

SA Power Networks requested an interim waiver in respect of the:

- legal separation obligations listed in clause 3.1 of the Guideline, and
- functional separation obligations listed in clause 4 of the Guideline.

SA Power Networks submitted it is applying for the waiver so that it can meet the SA Government's request to undertake the temporary generation project in line with proposed timing without breaching the Guideline.³

SA Power Networks requested that the waiver apply for the period commencing 14 March 2017 until 1 June 2020. That is, the period from the SA Government's announcement of its Energy Plan until the end of the initial operational phase (one year), plus a potential second year, plus a six-month decommissioning period.

SA Power Networks submitted that, if the waiver was refused:

- it would be unable to deliver the project to the SA Government's timeframes and meet its obligations under the Guideline. SA Power Networks would therefore choose to exit the project
- the SA Government's requested start date for the temporary generation would be substantially exceeded
- the SA Government would incur sunk costs, and
- load shedding of customers may eventuate.

³ On 4 May 2017, the AER wrote to SA Power Networks requesting further information to support its application. On 8 May 2017, SA Power Networks provided a copy of a letter it had received from the SA Government Department of the Premier and Cabinet, setting out the SA Government's request for assistance.

3 AER's draft decision and reasons

Clause 5.3.1 of the Guideline states that the AER may make a decision to either:

- grant the waiver subject to any conditions the AER considers appropriate, or
- grant the waiver as an interim waiver subject to any conditions the AER considers appropriate, or
- refuse to grant the waiver.

3.1 AER's draft decision

We consider that an interim waiver is not necessary in this instance. We will follow the standard assessment process for this waiver application.

The AER proposes to waive SA Power Networks' obligation⁴ to comply with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline until 1 June 2020⁵ for SA Power Networks' temporary generation project. This is on the following conditions:

- that the generation capacity is only utilised for the purpose of avoiding load shedding for NEM operational purposes when there is no alternative generation available
- is only utilised at the direction of AEMO or the South Australian Energy Minister, and
- is fully funded by the SA Government, who also receives all revenues from the project.

SA Power Networks will be expected to comply with the Guideline in all other circumstances, and in all other respects.

We now invite submissions from interested parties in relation to this draft decision. After consideration of any submissions, we will prepare our final decision.

3.2 AER's reasons

The Guideline requires that, in assessing a waiver application and coming to a decision, the AER must have regard to⁶:

- the NEO
- the potential for cross-subsidisation and discrimination if the waiver is granted or refused
- whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the DNSP of complying with that obligation

⁴ By issuing a notice under clause 5.3.1 of the Guideline.

⁵ This waiver will be granted from the time that this waiver application is decided, assuming our draft decision is affirmed, until 1 June 2020.

⁶ As required by clause 5.3.2 of the Guideline.

and may:

- have regard to any other relevant matter
- request further information from the DNSP
- invite public submissions on the application, and
- otherwise conduct such consultation as we consider appropriate with any person.

3.2.1 Request for interim waiver

Clause 5.3.3 of the Guideline provides that the AER may grant an interim waiver without having regard to any of the matters specified at clause 5.3.2. We may then make a further decision to grant or refuse the waiver, or allow the interim waiver to expire on a specified date.

We consider it likely that interim waivers will be granted in exceptional circumstances only. Significant factors in deciding to grant an interim waiver will be that:

- we consider we will not be able to make a final decision about the waiver application before the date on which the DNSP would be non-compliant with our Guideline in the absence of the waiver, or
- we consider it reasonable to allow the DNSP a transitional period where we have decided not to grant, or to vary or revoke, a substantive (that is, non-interim) waiver.

Clause 7.1(a) of the Guideline requires that a DNSP must fully comply with each of the obligations in clauses 3 and 4 of the Guideline in respect of its existing services as soon as reasonably practicable, having regard to the likely costs of having to fully comply with those obligations any sooner, but in any event no later than 1 January 2018. However, we consider that the services to which the waiver application relates are new services, as they do not involve any legacy arrangements that would require amendment in order to comply with the Guideline. We therefore consider that, unless the waiver is granted, SA Power Networks would be required to comply with the Guideline in respect of those services from 1 December 2017 (that is, from the date on which the temporary generation becomes operational).

SA Power Networks requested the AER grant an interim waiver to enable it to meet the SA Government's target date for operation of the temporary generation. We are satisfied an interim waiver is not required because SA Power Networks is unlikely to be in breach of the Guideline until the temporary generators are operational, from 1 December 2017.

The standard assessment process allows for us to fully consider the matters specified at clause 5.3.2 and also invite submissions from interested parties. The standard assessment process will apply except in exceptional circumstances. While we note that the temporary generation is not due to be operational until 1 December 2017, we also note that the timeframe set by the SA Government for commissioning and constructing the generators is limited. We accept that a timely waiver assessment process will assist SA Power Networks to decide whether to enter into agreements and other arrangements necessary to progress the development of the new temporary generation service.

On this basis, we consider the standard assessment process is appropriate for this application. In this case, to the extent possible, we are aiming to expedite that process. Our timetabling objective is to complete our standard assessment process for this matter by 5 July 2017.

3.2.2 Scope of waiver

SA Power Networks has sought a waiver from all of the:

- legal separation obligations listed in clause 3.1 of the Guideline, and
- functional separation obligations listed in clause 4 of the Guideline.

However, a waiver is only available in relation to clauses:

- 3.1 - Legal separation
- 4.2 - Physical separation, staff separation, branding and cross-promotion and office and staff registers, and
- 4.4.1(a) - Ensuring that any new or varied agreement between the DNSP and a service provider requires that service provider to comply with the relevant clauses of the Guideline.

Therefore, we will conduct our assessment in relation to these clauses only.

3.2.3 National Electricity Objective

With regard to the NEO, SA Power Networks submitted that:

- the operation will be temporary and will facilitate the delivery of the SA Government's Energy Plan
- the provision and operation of the temporary generation is designed to prevent the need for load shedding of customers in South Australia due to a shortfall in available generation
- the temporary generation will not normally affect the operation of the NEM
- the temporary generation will only be operated at the direction of AEMO or the South Australian Energy Minister
- the SA Government will bear all costs from the project and will also receive any market revenues from providing the generation
- the SA Government considers SA Power Networks is likely to be able to deliver the project at the least cost.

We consider that:

- based on the assessment of the SA Government in its Energy Plan, granting the waiver is likely to enable the project to be delivered at a lower cost. The project, regardless of the entity that delivers it, is likely to represent a significant cost to the SA Government. If the waiver is refused, these costs may be higher (including both sunk costs in relation to SA Power Networks' delivery of this project, and any additional costs that a new provider,

and the SA Government, might incur in order for the new provider to deliver the project in lieu of SA Power Networks).

- as the generator will not normally be operated as part of the NEM, it will not normally affect the NEM pool price in South Australia. In the exceptional circumstances where the generator is operated to help prevent load shedding, consumers are likely to benefit by paying a lower price for electricity received in times of shortage than they would without the temporary generation in operation.
- based on SA Power Networks' submissions that the costs of the temporary generation will be borne by the SA Government, that SA Power Networks will not be able to earn revenue from the temporary generation, and that SA Power Networks will not be able to decide when to operate the temporary generation, we consider that it is unlikely to gain any benefit from cross-subsidising or discriminating in favour of the temporary generation. On this basis, SA Power Networks' remaining role in relation to the temporary generation is unlikely to distort efficient investment in, or efficient operation and use of, other generation assets or services.

We consider, based on the assessments by the SA Government, that granting SA Power Networks a waiver to enable it to provide the temporary generation is likely to be consistent with the NEO, as long as: the temporary generation capacity is only utilised for the purpose of avoiding load shedding for NEM operational purposes when there is no alternative generation available; is only utilised at the direction of AEMO or the South Australian Energy Minister; and the project is fully funded by the SA Government, who will also receive all revenue from providing the generation.

3.2.4 Potential for cross-subsidisation and discrimination if the waiver is granted or refused

With regard to the above, SA Power Networks submitted that:

- there are no incentives for it to cross-subsidise the temporary generation, as all costs associated with the provision, operation and decommissioning will be borne by the SA Government
- the provision and operation of the temporary generation will be structured as a specific project within its financial system and SA Power Networks will ensure separation of accounts and cost allocation and attribution, and
- sourcing of the temporary generation solution is being undertaken through a competitive process administered by SA Power Networks.

We consider that:

- based on SA Power Networks' submission, it will not be able to earn revenue or make a profit from the temporary generation, it will only be able to recover its costs from the SA Government. It is therefore unlikely to have an incentive to cross-subsidise the temporary generation, as it will gain no advantage from doing so.
- SA Power Networks is also unlikely to discriminate in favour of the temporary generation. The provision of temporary generation services in the case of load shedding in South Australia is unlikely to be contestable. It is therefore unlikely that SA Power

Networks would gain any competitive advantage from attempting to discriminate, as SA Power Networks will not have the power to make a decision to operate the temporary generation capacity.

Therefore, we consider that there is unlikely to be potential for cross-subsidisation or discrimination whether the waiver is granted or refused, as long as: the generation capacity is only utilised for the purpose of avoiding load shedding for NEM operational purposes when there is no alternative generation available; the temporary generation capacity is only utilised at the direction of AEMO or the South Australian Energy Minister; and the project is fully funded by the SA Government, who will also receive any market revenues from providing the generation.

3.2.5 Balance of benefits and detriments from complying

With regard to the likely balance of benefits to electricity consumers and costs to SA Power Networks of SA Power Networks complying with clauses 3.1, 4.2 and 4.4.1(a), SA Power Networks submitted:

- It is unable to both deliver the project by 1 December 2017 and comply with the above obligations of the Guideline. If it is obliged to comply with the above clauses of the Guideline it will not deliver the project.
- In the absence of the project, load shedding is more likely to occur. Therefore complying with the Guideline would result in detriment to electricity customers
- There is no benefit to electricity customers of SA Power Networks complying with these provisions of the Guideline with respect to the temporary generators.

We consider that:

- If SA Power Networks complies with the Guideline in relation to the above clauses, it will not be able to deliver the temporary generation. It will therefore not incur any additional costs in order to comply with Guideline. (SA Power Networks will still be required to comply with the Guideline in respect of its other activities). Similarly, consumers will not receive any benefit from SA Power Networks complying with the Guideline

In these circumstances, therefore, the benefits for consumers of SA Power Networks complying with Guideline would not outweigh the costs to SA Power Networks of doing so.

3.2.6 Duration of the waiver

With regard to the requested duration of the waiver, SA Power Networks submitted that, while it is progressing the establishment of its new ring-fenced entities to legally separate its existing unregulated business activities, the compressed SA Government timeframes mean that using these entities as the vehicle for the temporary generation project is not feasible.

SA Power Networks also submits that it expects decommissioning to occur no more than six months after the end of the operational period, which will last one to two years. On this basis, if the operational period ends sooner, decommissioning of the plant will occur earlier.

We accept that it is likely to be difficult for SA Power Networks to achieve all of the obligations of the Guideline in respect of the temporary generation project by 1 December 2017.

Given the proposed limited duration of the project (that is, until 1 June 2020), we consider it appropriate, in this case, that the waiver should apply for the duration of the project (instead of SA Power Networks being required to comply with the Guideline at a later time prior to the project coming to an end). However, we consider it is not appropriate to grant a waiver retrospectively. Therefore, we consider the waiver should be granted from the date of our final decision on SA Power Networks' waiver application and ending 1 June 2020.