



Draft Decision

Ergon Energy application for waiver from Queensland Ring Fencing Guidelines

December 2015

© Commonwealth of Australia 2015

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 4141,
Canberra ACT 2601
or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au
AER Reference: D15/177932

Contents

Shortened forms	1
Request for submissions	2
1 Summary	3
2 Queensland Ring Fencing Guidelines	4
2.1. Procedure for waiving ring fencing obligations.....	4
3 Ergon Energy’s waiver application	5
3.1. GUSS units	5
3.2. A related business	5
3.3. Costs of compliance with ring fencing obligations	6
3.4. Reasons for seeking a waiver	6
4 Our assessment.....	7
4.1. Submissions	7
4.2. Our considerations	8
4.3. Our draft decision	9

Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
DNSP	Distribution Network Service Provider
Ergon Energy	Ergon Energy Corporation Limited
NEL	National Electricity Law
NEM	National Electricity Market
NER	National Electricity Rules
QCA	Queensland Competition Authority
Guidelines	Electricity Distribution: Ring-Fencing Guidelines, September 2000 ¹

¹ By Queensland Competition Authority.

Request for submissions

This document sets out the Australian Energy Regulator's (AER) draft decision on an application from Ergon Energy Corporation Limited (Ergon Energy) for a waiver from the Queensland Electricity Distribution Ring–Fencing Guidelines (the Guidelines).² Ergon Energy's waiver application relates to a requirement under section 1(b) of the Guidelines specifying Ergon Energy may not carry on a business related to its role as an electricity DNSP.

Copies of Ergon Energy's waiver application are available on the AER's website www.aer.gov.au.

We invite submissions from interested parties on Ergon Energy's waiver application and this draft decision.

Submissions should be emailed to [AERInquiry@aer.gov.au](mailto:AERInquiry@ aer.gov.au) before **5pm on Friday 22 January 2016**. Enquiries may be emailed to the same AER email address. Alternatively, submissions may be mailed to:

Mr Chris Pattas, General Manager Network Investment and Pricing
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

We prefer 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.

All non-confidential submissions will be placed on the AER website.

² Queensland Competition Authority, *Electricity Distribution Ring–Fencing Guidelines*, September 2000.

1 Summary

On 29 October 2015 Ergon Energy submitted an application for a waiver from its ring fencing obligations in respect of its Grid Utility Storage System (GUSS) units. Section 1(b) of the Guidelines prevents a Distribution Network Services Provider (DNSP) from carrying on a "related business" within its legal entity. A "related business" is defined by the Guidelines as a business of producing, purchasing or selling electricity.

Ergon Energy intends to own and operate 20 GUSS units to augment SWER feeders and remove the need for pole and wire upgrades. Ergon Energy stated GUSS units use smart technology coupled with energy storage.³

GUSS units fall within the definition of a "related business" in the Guidelines because they inject electricity into the network. i.e. producing electricity. The waiver, if granted, would allow Ergon Energy to own and operate the GUSS units as a related activity.

Ergon Energy submitted it will not sell electricity injected by GUSS units into the network so will not receive an immediate financial benefit. We note there is opportunity for operators of assets such as GUSS to benefit by charging batteries during low price periods and selling during high price periods. Therefore we consider it appropriate Ergon Energy submits a ring fencing waiver application for our assessment.

Having considered materials submitted by Ergon Energy and taken into account submissions provided in response to its ring fencing application, our draft decision is to grant a temporary waiver from section 1(b) of the Guidelines. The waiver is limited to the 20 GUSS units described by Ergon Energy in its waiver application. The waiver is also conditional on Ergon Energy not selling electricity injected into the network by GUSS units. The waiver will remain in place until 12 months after we release new national ring fencing guidelines, due before December 2016. Alternatively, new national ring fencing guidelines may specify an approach to pre-existing waivers such as this.

The new national guidelines will supersede existing jurisdictional ring fencing guidelines currently administered by the AER. In respect of these 20 GUSS units, Ergon Energy will be required to comply with the new guidelines within 12 months after being established, or otherwise comply with transitional arrangements for existing waivers as set out by the new guidelines.

³ Ergon Energy, *Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines*, pp. 3–4.

2 Queensland Ring Fencing Guidelines

The Queensland Competition Authority (QCA) published its Ring-fencing Guidelines in September 2000. The objective was to underpin an environment where the price, quantity and quality of electricity traded in the retail, generation and distribution markets was not biased due to vertical integration of distribution and other businesses.⁴ The Guidelines recognised the potential need for ring fencing waivers in certain circumstances to capture activities where the cost imposed by complying with the ring-fencing obligations could outweigh the likely benefit to the public.

On 1 July 2010 the AER assumed responsibility for administering the Guidelines. Under clause 11.14.5(b)(3) of the NER, guidelines in force for a participating jurisdiction immediately before the AER's assumption of regulatory responsibility (transitional guidelines) continue to be in force for that jurisdiction subject to amendment, revocation or replacement by the AER. The AER has not made any amendment, revocation or replacement in respect of the Guidelines to date.

2.1 Procedure for waiving ring fencing obligations

Section 1 of the Guidelines sets out the minimum ring-fencing obligations imposed on the Queensland DNSPs. A DNSP has the right to seek a waiver from these obligations under section 21 of the Guidelines:

“The QCA may, by notice to a DNSP, waive any of a DNSP's obligations under section 1 provided that the QCA is satisfied that the DNSP can demonstrate that the administrative cost to the DNSP and its Associates of complying with the obligation outweighs the benefit, or any likely benefit, to the public.”

Where a DNSP applies for waiver of its ring-fencing obligations, the AER must follow the procedure set out in sections 22 to 30 of the Guidelines in assessing the application.

On 20 November we published a notice in The Australian newspaper to seek comment on Ergon Energy's waiver application. We also published the waiver application on the AER website and issued an email alert to AER subscribers. We received one submission.

⁴ Queensland Competition Authority, *Final Determination: Electricity Distribution: Ring-Fencing Guidelines*, September 2000, p.8.

3 Ergon Energy's waiver application

The waiver sought by Ergon Energy is in regard to section 1(b) of the Guidelines, which states:

"A Distribution Network Service Provider (DNSP) that provides prescribed distribution services in Queensland must not carry on a related business with that legal entity"

A "related business" is defined in section 30 of the Guidelines as a business of producing, purchasing or selling electricity.

3.1 GUSS units

Ergon Energy's waiver application described identifying a need for SWER network support assets but being unable to find a suitable existing solution. Ergon Energy partnered with Magellan Power Electronics (Western Australia) to develop the GUSS.

Ergon Energy described each GUSS unit as providing 100 kWh of energy storage via lithium ion batteries. Positioned near the end of single wire earth return (SWER) power lines, typical of Ergon Energy's network in regional Queensland, GUSS will inject energy to support network voltage and meet demand at times of local network congestion. By supplying energy in demand peaks Ergon Energy submitted the GUSS units will allow auxex to be postponed or avoided.

Ergon Energy's waiver application indicated two GUSS units have been installed and are being energised. A further 18 GUSS units are being installed across 12 SWER 'schemes'. Ergon Energy submitted the total cost of the GUSS program over 3 years is \$15.5 million, including transport, labour costs, etc. Ergon Energy is funding the GUSS rollout through deferment of capital works. Ergon Energy submitted that the traditional (SWER) option, to upgrade the poles and wires, would cost \$20.1 million.⁵

3.2 A related business

Ergon Energy submitted:⁶

"Ergon Energy acknowledges there may be some suggestion that the GUSS units could be considered to be units which produce electricity ... and may therefore be deemed as generation assets. However, the Ring Fencing Guidelines applicable to Ergon Energy ... do not specifically consider such assets in the context of the term (generation). In any case, it is not necessarily clear that the use of these units can be classified as a related business for the purpose of the Ring Fencing Guidelines. Although a legal definition or 'business' is not readily identifiable, dictionary meanings include:

- one's occupation, profession or trade

⁵ Ergon Energy, *Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines*, p. 2.

⁶ Ergon Energy, *Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines*, pp. 5–6.

- the purchase and sale of goods and services in an attempt to make a profit
- commercial activity and
- an established or going enterprise or concern.

Based on this definition, Ergon Energy proposes that the ongoing operation of these assets does not constitute a 'business'. In particular, their (ownership and) operation does not represent a commercial activity and there is no attempt to make profits from ownership or operation of the assets."

3.3 Costs of compliance with ring fencing obligations

For a ring-fencing waiver to be granted Ergon Energy must demonstrate the administrative cost of complying with the ring-fencing obligation outweighs the benefit, or any likely benefit, to the public.

Ergon Energy submitted were it to be required to separately ring fence GUSS unit operation from its main business activities it would incur a range of additional costs.⁷ We have taken those proposed costs into account.

3.4 Reasons for seeking a waiver

Ergon Energy submitted that establishing a separate ring fenced entity would, in addition to incurring a range of costs, require lengthy consultation with the Queensland Government as its owner.⁸ Further, that the Queensland Government is hesitant to establish new government owned corporations.

Ergon Energy also submitted that operation of the GUSS units would not impact the National Electricity Market (NEM), would not equate to Ergon Energy entering the generation market and is a lower cost solution than traditional network augmentation investment.⁹

⁷ Ergon Energy, *Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines*, Confidential Appendix 1.

⁸ Ergon Energy, *Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines*, p. 6.

⁹ Ergon Energy, *Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines*, p. 7.

4 Our assessment

As set out above, we may waive a ring-fencing requirement if satisfied the administrative cost to the DNSP in complying with the ring-fencing obligations outweighs the benefit, or any likely benefit, to the public.

4.1 Submissions

We received four submissions on Ergon Energy's waiver application, all of which are available to view on the AER website.

Overall the submissions opposed granting Ergon Energy a waiver. A range of reasons were provided but a consistent theme was that Ergon Energy should not be permitted to maintain barriers to entry by third parties. That is, Ergon Energy should either purchase network energy storage services from alternative providers or customers of Ergon Energy should themselves install batteries beyond the meter.

A submission from PIAC emphasised the market development benefits of forcing electricity networks to source storage and potential substitute services from external providers.¹⁰ Energy Consumers Australia (ECA) submitted that while potential price arbitraging or other financial benefits to Ergon Energy might be small, they are not zero and operation of GUSS units by a third party would be preferable.¹¹ ECA noted such benefits would grow as the scale of any future GUSS rollout increased beyond the current program of 20 units, giving greater weight to separating GUSS operation from Ergon Energy's operation of the broader network.

Mr John Herbst submitted that the GUSS units will displace not only customer owned batteries but also non-battery solutions such as energy efficiency initiatives or community micro grids.¹² However, Mr Herbst also noted:¹³

"To be clear, I do not claim to know that any particular configuration of technology is better than any other, and Ergon's proposed solution may be optimal in some sense of the term."

Mr Marcus Steel submitted Ergon Energy's waiver application seeks to preserve the boundary of its monopoly activities.¹⁴

We have taken submissions into account in forming our view on Ergon Energy's waiver application.

¹⁰ PIAC, Ergon Energy application for ring fencing waiver, December 2015, p. 1.

¹¹ ECA, *Ergon application for ring fencing waiver*, December 2015, p. 1.

¹² John Herbst, *Submission on Ergon Energy's ring fencing waiver*, November 2015, p.1.

¹³ John Herbst, *Submission on Ergon Energy's ring fencing waiver*, November 2015, p. 3.

¹⁴ Mr Marcus Steel, *Ergon Energy ring fencing waiver*, December 2015.

4.2 Our considerations

We accept Ergon Energy's GUSS units are to operate only to provide network support, not to engage in electricity supply for financial benefit. As such, we consider operation of the GUSS units will not equate to "the business" of producing, purchasing or selling electricity.

Mr Herbst submitted it is incorrect to say Ergon Energy will not benefit financially from the GUSS units.¹⁵ This is because Ergon Energy will add the GUSS units to its regulatory asset base (RAB) and earn a rate of return on the asset value. In response, we note Ergon Energy's rationale for the GUSS units is to displace more expensive network augmentation investment which would increase the RAB by even more. Also, the scale of the GUSS project is insufficient to materially influence the size of the RAB or network prices paid by electricity consumers. A separate issue is whether distributors should be permitted to themselves invest in and operate battery storage assets.

We agree with the ECA and PIAC that it may be appropriate for DNSPs to source network storage services from third parties, particularly if they intend to arbitrage in the wholesale market between high price and low price periods. In this instance Ergon Energy has confirmed it will not sell electricity injected into the network so these concerns drop away, at least in part. Moreover, our decision to grant a temporary waiver is conditional on Ergon Energy not selling electricity provided by GUSS units.

With respect to the market development issues raised in submissions, we are aware of the growing importance of battery storage technologies, both for electricity network service providers (NSPs) and customers. Our new national ring fencing guidelines will necessarily have regard to battery storage technologies and how related services may best be provided. The Guidelines, however, are focussed on the potential for DNSPs to vertically integrate to provide generation or retail services. Hence the emphasis on a "related business" defined as producing, purchasing or selling electricity. It is this issue which is the subject of Ergon Energy's waiver application and on which we are required to form a view.

The AEMC has undertaken a review of the implications posed by energy storage technologies for the regulatory framework formed by the National Electricity Law (NEL) and National Electricity Rules (NER).¹⁶ For network storage, such as GUSS, the AEMC recommended we consider a range of factors when determining appropriate ring-fencing to apply in different circumstances.¹⁷ The AEMC's recommendations were made in the context of us developing new national ring fencing guidelines, not in the context of existing jurisdictional ring fencing arrangements.

For the current waiver application from Ergon Energy, we consider granting a temporary and conditional waiver under the existing Guidelines is appropriate in light of our development of new national ring fencing guidelines over the 2016 calendar year.

¹⁵ John Herbst, *Submission on Ergon Energy's ring fencing waiver*, November 2015, p. 1.

¹⁶ AEMC, *Final report — Integration of Storage: Regulatory Implications*, December 2015.

¹⁷ AEMC, *Final report — Integration of Storage: Regulatory Implications*, December 2015, p. iv.

4.3 Our draft decision

For the above reasons we consider granting a temporary and conditional waiver is appropriate. Our draft decision is to grant a temporary waiver from section 1(b) of the Guidelines, conditional on Ergon Energy not selling electricity injected into the network by GUSS units. The temporary waiver relates only to the 20 GUSS units described by Ergon Energy in its waiver application.

Ergon Energy will be required to comply with national ring fencing guidelines within 12 months of them being established, or otherwise comply with arrangements for existing ring fencing waivers as set out by the new guidelines.