



Final Decision Ergon Energy Ring-fencing Waiver

Provision of Field Services to Powerlink

May 2020

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
CAM	Cost Allocation Methodology
DNSP	Distribution network service provider
NEO	National Electricity Objective
NER	National Electricity Rules
SLA	service level agreement
TNSP	Transmission network service provider

1 Summary

We have decided to grant a ring-fencing waiver, effective on 12 May 2020, to allow Ergon Energy to provide field services on behalf of Powerlink until 30 June 2025. Allowing Ergon Energy to provide field services to Powerlink will assist Powerlink in providing regulated transmission services that are not contestable.

On 23 December 2019, Ergon Energy submitted an application for a waiver from its obligation(s) under clause 3.1(b) and clause 4.2 of the Electricity Distribution Ring-fencing Guideline (Ring-fencing Guideline). Ergon Energy previously provided these field services to Powerlink under a service level agreement (SLA). In 2018, Ergon Energy's affiliated entity, Yurika, commenced providing these services instead of Ergon Energy. Yurika was established by Ergon Energy to provide a number of ring-fenced services when the Ring-fencing Guideline came into operation in 2018.¹ While Yurika will continue to provide many of these services, Ergon Energy is proposing to provide field services to Powerlink instead of Yurika and is consequently seeking a waiver to do so.²

In its application, Ergon Energy submitted the waiver would be in the best interest of consumers. Ergon Energy argued if the waiver is refused there will be an inability to leverage efficiency savings of Ergon Energy performing the support services, including resource management, works scheduling and related corporate and support services.

We agree with Ergon Energy. We consider there is no benefit to consumers in requiring Ergon Energy to comply with these provisions of the Ring-fencing Guideline in this instance. We consider that the two main harms ring-fencing aims to prevent (the risk of cross-subsidisation and discrimination) are already adequately addressed. We therefore grant the waiver because it is in the long-term interests of consumers.

¹ The ring-fenced services provided by Yurika include a virtual power plant, metering services, microgrid services, electrical contracting, private network consulting and construction, electric vehicle charging infrastructure, community batteries, sale of distributed solar PV services and the field services it currently provides to Powerlink that were previously provided by Ergon Energy.

² The AER granted a waiver to Ergon Energy in 2017, allowing it an additional six months (from 1 January 2018 to 30 June 2018) to novate existing services to Yurika.

2 About ring-fencing

Ring-fencing refers to the separation of the direct control distribution services provided by a DNSP from the provision of unregulated or contestable services by a DNSP, or an affiliated entity. Our Ring-fencing Guideline sets out obligations that apply to a DNSP if it wishes to provide unregulated or contestable services. The obligations target two potential harms that can occur if a DNSP decides to offer services in a contestable market.

First, the Guideline addresses the risk of DNSPs cross-subsidising contestable services with revenue earned from their provision of distribution services. Second, the Guideline addresses the risk of DNSPs discriminating in contestable markets in favour of their own business units that provide contestable distribution services, or one of its affiliated entities that provide contestable electricity services.

A DNSP possesses a significant amount of information about its electricity network. This information could provide it with an unfair advantage in a competitive market. Ring-fencing is designed to enable a DNSP or its affiliates to participate in a contestable market on a fair basis.

In this way, ring-fencing aims to drive effective competition where it is feasible, to open up new markets to competition, and to provide effective regulation where competition is not feasible. Compliance with the Guideline helps to give consumers access to a range of products, services and suppliers, with bills that are no higher than they need to be.

The Ring-fencing Guideline recognises that strict adherence to the obligations might, in some circumstances, result in outcomes that are not in the interests of consumers. This is why the Guideline makes provision for ring-fencing waivers. Waivers provide the ring-fencing framework with flexibility by allowing DNSPs exemptions. A DNSP may apply to the AER for a waiver in regard to most aspects of the Guideline. The decision on whether to grant a waiver from the Guideline is made by the AER.

Clause 5.3.2 of the Ring-fencing Guideline states that, in assessing a waiver application and deciding whether to grant a waiver (subject to any conditions) or refuse to grant a waiver, the AER must have regard to:

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

Clause 5.3.2 of the Guideline also states that we may have regard to any other matter we consider relevant.

3 Ergon Energy Networks' waiver application

3.1 Background

Prior to 2018, Ergon Energy provided field services to Powerlink to assist it in the provision of prescribed and negotiated transmission support services. These services were provided under a SLA between the parties. Ergon Energy first began providing these services on behalf of Powerlink in the late 1990s.³

When the Ring-fencing Guideline came into effect on 1 January 2018, Ergon Energy had to transfer the field services it provided to Powerlink to an affiliate or apply to the AER for a waiver of its ring-fencing obligations. In December 2017, Ergon Energy sought and was granted a ring-fencing waiver to allow Ergon Energy an additional six months (until 30 June 2018) to novate its existing SLA.⁴ Subsequently, Ergon Energy novated the SLA to Yurika, a commercial business that is an affiliate of both Ergon Energy and Powerlink.

Powerlink has indicated that it now wishes to return to the field services arrangements it had in place with Ergon Energy prior to 2018. To do so, a ring-fencing waiver would be required. This is because the services that Ergon Energy wishes to provide on behalf of Powerlink are not distribution services. Ordinarily, a business that provides distribution services, and also wants to provide services that are not distribution services, must provide the non-distribution services through a separate legal entity. It must also provide these services in a way that is separate from its direct control services, or apply for a waiver of these obligations.

3.2 Waiver application

Ergon Energy submitted an application to the AER for a waiver of its obligations under the Ring-fencing Guideline on 23 December 2019.⁵ Specifically, Ergon Energy submitted a waiver of:

- the legal separation obligation under clause 3.1(b) of the Ring-fencing Guideline which states that a DNSP may provide distribution services and transmission services but must not provide other services; and
- the functional separation obligations under clause 4.2 of the Ring-fencing Guideline which provides that a DNSP may not co-locate direct control services and contestable electricity services, may not share staff between direct control services and contestable electricity services, and may not use the same branding for both direct control services and contestable electricity services.

³ We note for clarity, that under the Ring-fencing Guideline Ergon Energy and Powerlink are indirectly affiliated entities. However, we consider this is not material to this decision.

⁴ AER, Decision: DNSP Applications for Waivers from the Electricity Distribution Ring-fencing Guideline, December 2017.

⁵ Ergon Energy's Ring-fencing Waiver Application, 23 December 2019.

Ergon Energy submitted the intent of its waiver application is to deliver on its commitment to providing Queensland customers with services that are affordable, sustainable and safe.⁶ It submitted that it has highly skilled staff performing work in the same areas as Powerlink and that the waiver will therefore allow for scale efficiencies at a regional level. Ergon Energy proposed that the waiver, if granted, extend until the end of the next regulatory control period, being 30 June 2025.

⁶ Ergon Energy's Ring-fencing Waiver Application, 23 December 2019, p. 3.

4 Assessment

In assessing Ergon Energy's waiver application, we have considered the factors outlined in clause 5.3.2 of the Ring-fencing Guideline.

The field services Ergon Energy proposes to provide to Powerlink are contestable. However, the field services will contribute to prescribed and negotiated transmission services that are regulated by the AER and are not contestable.

We are satisfied the risks of cross-subsidisation and potentially discriminatory behaviour that ring fencing aims to prevent are adequately accounted for or are not relevant in this situation, as discussed below. On 26 February 2020, we sought submissions from interested stakeholders on Ergon Energy's waiver application by 27 March 2020. We did not receive any submissions on the application.

4.1 Benefits to customers from Ergon Energy complying with the obligations

In this situation we consider the benefits to consumers from compliance with the Guideline will not be diminished by approving the waiver Ergon Energy is seeking. Generally, the Ring-fencing Guideline benefits consumers by addressing the risk of:

- DNSPs cross-subsidising contestable services with revenue earned from their provision of distribution services; and
- DNSPs discriminating in contestable markets in favour of their affiliated entities providing contestable electricity services.

In regard to Ergon Energy's ring-fencing waiver, however, we are satisfied consumers will benefit from granting this waiver for the reasons set out below.

4.1.1 Cross-subsidy

We consider the risk of cross-subsidisation is adequately addressed by Ergon Energy's Cost Allocation Method (CAM). Ergon Energy submitted that it maintains separate accounts for its regulated distribution services, unregulated distribution services and non-distribution services in accordance with the principles and policies of its CAM. The AER reviewed and approved Ergon Energy's amended CAM in November 2018.⁷ Additionally, Powerlink's regulated services, the subject of this waiver, are regulated by the AER in accordance with the National Electricity Rules (NER). We consider that the risk of cross-subsidisation is adequately addressed in the current version of the CAM.

⁷ AER, Final Decision: Energex Ltd and Ergon Energy Ltd Cost Allocation Method, November 2018.

4.1.2 Discriminatory behaviour

In respect of this waiver, the issue to consider is whether Ergon Energy would have an advantage in providing field services to Powerlink as a result of its position as a regulated network business compared with alternative service providers of field services.

We consider there is no risk of Ergon Energy having a discriminatory advantage in providing field services to Powerlink. There are several reasons for this:

- any suitably qualified third party could offer field services to Powerlink, and Ergon Energy has no known advantage over third parties stemming from being a DNSP. This means the staff sharing and office sharing restrictions need not apply. The Guideline already allows these restrictions to be relaxed in situations where there is 'no opportunity' to use the information held by a DNSP to advantage an affiliate, which appears to be the case in regard to this waiver;
- branding restrictions are designed to prevent DNSPs using their brand in a way that might confuse customers. That is, contestable services cannot ordinarily be marketed using the brand of a DNSP. In the circumstance of this waiver, these branding concerns are not relevant as there is no likelihood of the customer, Powerlink, being confused. Thus, there is no advantage from the use of the Ergon Energy brand in providing these services to Powerlink; and
- no submissions were received in response to our invitation to comment on Ergon Energy's waiver application. Aside from publishing the waiver application on our website, we directly invited a number of stakeholders we thought may have interest in this waiver.

4.2 Cost of compliance to Ergon Energy

Ergon Energy is already meeting the cost of its obligations under the Ring-fencing Guideline. Its affiliated entity, Yurika, was established in 2018 and provides field services, among a range of other ring-fenced services, to support Powerlink's provision of prescribed and negotiated transmission services. At issue is whether the benefits of Yurika continuing to provide these services outweigh any costs of compliance. If the benefits do not exceed the costs of compliance, it may be prudent to grant the waiver.

We granted Ergon Energy's ring-fencing waiver application allowing it to continue providing field services to Powerlink while Yurika was being established.⁸ The waiver was granted for an additional six months, as requested. With the formation of Yurika, Ergon Energy did not seek to extend this waiver. The SLA to provide field services was transferred to Yurika on 30 June 2018. It should be noted that if the waiver Ergon Energy is now seeking is granted, Yurika will continue to provide a range of other ring-fenced services in accordance with the Ring-fencing Guideline. No establishment costs associated with the formation of Yurika will have been wasted.

⁸ AER, Decision: DNSP Applications for Waivers from the Electricity Distribution Ring-fencing Guideline, December 2017.

Powerlink advised us the current arrangements for it to obtain field services from Yurika has added complexity to its service delivery. This has led to a deterioration in service reliability and quality.

Ergon Energy submitted that providing these services in-house would create scale efficiencies resulting in cost reductions for both organisations. Ergon Energy submitted that alternative approaches duplicate Ergon Energy's capacity and result in inefficiencies. It claimed if the waiver is refused, there are opportunities that cannot be realised.

We therefore consider in the absence of a benefit to consumers from compliance with the Ring-fencing Guideline (as noted above), any potential costs associated with compliance are not warranted.

4.3 Conclusion

We consider that there is no benefit in requiring Ergon Energy to comply with these provisions of the Ring-fencing Guideline. Based on the information presented by Ergon Energy, which we have accepted, it could be detrimental to consumers not to grant the waiver. Overall, we consider the risks of cross-subsidisation and discrimination, if the waiver is to be granted, are adequately addressed. For these reasons, we consider that granting the waiver will promote the NEO.

5 Decision

We grant Ergon Energy a waiver from its obligations to comply with clause 3.1(b) and clause 4.2 of the Ring-fencing Guideline, in respect of field services that it provides to and on behalf of Powerlink, from 12 May 2020 until 30 June 2025.