



Decision

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

June 2017

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Director, Corporate Communications
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601
or publishing.unit@acc.gov.au.

Tel: 1300 585165

Email: ringfencing@aer.gov.au

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Shortened forms

Shortened form	Extended form
AEMO	Australian Energy Market Operator
AEC	Australian Energy Council
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

1 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.

Our final decision is to confirm our draft decision, issued on 26 May 2017, to grant the waiver sought on the conditions specified below. The waiver will apply from 21 June 2017 to 1 June 2020.

SA Power Networks sought this waiver until 1 June 2020 to enable it to design, construct, commission, connect and operate 200MW of temporary generation from 1 December 2017, at the request of 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 is part of the SA Government's energy plan 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. However, 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 to ensure it is operational by 1 December this year.

We made a draft decision on 26 May 2017 to grant a conditional waiver given the circumstances under which the generation assets were to be used. Following consultation with interested parties, we have decided to uphold the decision to grant a conditional waiver, with a further condition added since the draft determination to ensure that SA Power Networks cannot (and will not) advertise or promote other merchant generation services.

The waiver is granted on the condition 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
- it is only utilised at the direction of AEMO or the South Australian Energy Minister
- it is fully funded by the SA Government, who also receives all revenues from the project, and
- SA Power Networks cannot (and will not) advertise or promote other merchant generation services.

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

The AER has decided to grant SA Power Networks a conditional 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.

2 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.

2.1 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 a 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.

3 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.

3.1 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.

3.2 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 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.

3.3 Obligations on SA Power Networks

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

² See ourenergyplan.sa.gov.au

- 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.

3.4 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.

4 Our assessment

On 26 May 2017, we issued our draft determination on SA Power Networks' waiver application and invited submissions from interested parties, closing 9 June. We received three submissions from interested parties and one response from SA Power Networks. All are available from our website. We consider these submissions in our assessment below.

4.1 Submissions

We received submissions from the Government of South Australia Department of the Premier and Cabinet, the Australian Energy Council (AEC) and AGL Energy Limited (AGL).

The Department of the Premier and Cabinet supported granting SA Power Networks a waiver. It submitted:

We support the AER view that 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.⁴

The AEC supported granting SA Power Networks a partial waiver. However, it did not support granting a waiver of branding and cross promotion obligations under clause 4.2.3 of the Guideline. The AEC submitted:

The Energy Council understands the waiver application for the functional separation requirements from Part 4.1, 4.3, and 4.4 of the Guideline. The requirements of 4.2 of the Guideline are also subject to the waiver application. The Energy Council does not support excepting the requirements of 4.2.3, those regarding branding and cross promotion, as part of the waiver. The requirements of 4.2.3 do not seem unreasonable or difficult to comply with in regard to the jurisdictional direction. The Energy Council view is that confusion as to SAPN's role in the merchant energy market can and should be avoided.⁵

Similarly, AGL voiced its opposition to the waiver of the obligation under clause 4.2.3 of the Guideline, submitting:

AGL does not support the proposal that the waiver should remove the obligations on branding and cross promotion. AGL considers that the requirements outlined in clause 4.2.3 of the Ring-Fencing Guidelines are not unreasonable or onerous and would still enable SAPN to meet the direction set by the South Australian Government... AGL also wishes to take this opportunity to reiterate to the AER that network business activities which seek to operate in competitive markets must comply with the ring fencing guidelines in order to preserve competitive neutrality principles which are ultimately to the benefit of all market participants.⁶

SA Power Networks provided a detailed response to the submissions received, which is also available from our website. The submission responds to the AEC's concerns about its proposed waiver from clause 4.2.3. In summary, SA Power Networks submitted that:⁷

⁴ Government of South Australia Department of the Premier and Cabinet submission, 8 June 2017, page 1.

⁵ AEC submission, 9 June 2017, page 1.

⁶ AGL submission, 15 June 2017, pages 1-2.

⁷ SA Power Networks letter to AER responding to AEC submission on SA Power Networks ring-fencing waiver application, 15 June 2017, pages 1-3.

- SA Power Networks will not deliver other generation services into the wholesale market. SA Power Networks cannot (and will not) advertise or promote other merchant generation services. Its website will not advertise wholesale market generation services more broadly as these would not be direct control services nor 'distribution services'. Using SA Power Networks' website to seek tenders from other service providers for some aspects of the temporary generation project does not constitute advertising or cross-promoting.
- The legal entities that SA Power Networks is currently setting up will not be ready to trade before 1 January 2018 and therefore cannot be used to deliver the temporary generation project by 1 December 2017. Using SA Power Networks staff will necessarily mean utilising SA Power Networks branded uniforms, equipment and vehicles.
- There are no feasible alternatives to deliver the SA Government's project in the timeframe required. Because of this, allowing SA Power Networks to use its branding will not raise any potential harm to competition or confer any benefit to SA Power Networks by way of brand visibility since it is not part of an open, competitive market; the generation will only be used as backup, and only at the direction of AEMO or the South Australian Energy Minister to prevent load shedding. SA Power Networks will gain no further opportunity to provide wholesale market generation services.

4.2 Our considerations

The Guideline requires that, in assessing a waiver application and coming to a decision, the AER must have regard to⁸:

- 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

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.

4.2.1 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.

⁸ As required by clause 5.3.2 of the Guideline.

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 objective is to complete our standard assessment process for this matter by 5 July 2017.

4.2.2 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.

4.2.3 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. 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.

4.2.4 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.

With regard to interested parties:

- the AEC submitted that granting SA Power Networks a waiver in relation to obligation 4.2.3 of the Guideline may create confusion as to SA Power Networks' role in the merchant energy market, and
- AGL submitted that complying with the branding and cross-promotion obligation was not unreasonable or onerous and would preserve the principle of competitive neutrality.

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.
- we note the AEC's concern that SA Power Networks' role in the temporary generation project may lead to confusion over its role in the merchant energy market. However, given that (i) the project has been publically announced in the SA Government's Energy Plan, (ii) it has been announced in this waiver process, (iii) that SA Power Networks states in its submission that if it receives media or other enquiries in relation to the SA Government's temporary generation project it will provide factual responses advising

that this is a project being delivered by SA Power Networks for the SA Government, and (iv) the fact that this is a temporary project, we believe the likelihood of confusion is minimal.

- we accept SA Power Networks' claim that the costs of rebranding and replacing uniforms, equipment and vehicles in time to have the project installed and operational by 1 December 2017, if possible, would be prohibitively costly. However, to ensure that any harm is minimised, we will include a further condition on the waiver, as volunteered by SA Power Networks, to ensure that they will not advertise or promote other merchant generation services.

Therefore, we consider that there is unlikely to be potential for cross-subsidisation or discrimination if a waiver is granted, 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; the project is fully funded by the SA Government, who will also receive any market revenues from providing the generation; and SA Power Networks cannot (and will not) advertise or promote other merchant generation services.

4.2.5 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 is forced to comply with the Guideline in relation to the above clauses, it will not be able to deliver the temporary generation. While this would mean it would not incur any additional costs to comply with Guideline, consumers will not receive any benefit from SA Power Networks complying with the Guideline in respect of this project.

In these circumstances, therefore, the benefits for consumers of SA Power Networks complying with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline would not outweigh the costs to SA Power Networks of doing so.

4.2.6 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 meet 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. However, we consider it is not appropriate to grant a waiver retrospectively. Therefore, the conditional waiver is granted commencing 21 June 2017 and ending 1 June 2020.

4.3 Decision

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.

We consider that an interim waiver is not necessary in this instance.

The AER has decided to waive SA Power Networks' obligation⁹ to comply with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline from 21 June 2017 until 1 June 2020 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
- is fully funded by the SA Government, who also receives all revenues from the project, and
- SA Power Networks cannot (and will not) advertise or promote other merchant generation services.

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

⁹ By issuing a notice under clause 5.3.1 of the Guideline.