

Draft Decision

Energex application for waiver from Queensland Ring Fencing Guidelines

## Mobile educational exhibit

July 2016

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# Shortened forms

|  |  |
| --- | --- |
| Shortened form | Extended form |
| AEMC | Australian Energy Market Commission |
| AER | Australian Energy Regulator |
| DNSP | Distribution Network Service Provider |
| Energex | Energex 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]](#footnote-1) |

# Request for submissions

This document sets out the Australian Energy Regulator’s (AER) draft decision on an application from Energex Limited (Energex) for a waiver from the Queensland Electricity Distribution Ring–Fencing Guidelines (the Guidelines).[[2]](#footnote-2)

Energex’s waiver application relates to a requirement under section 1(b) of the Guidelines specifying that Energex may not carry on a business related to its role as an electricity Distribution Network Service Provider (DNSP).

Copies of Energex’s waiver application are available on the AER’s website [www.aer.gov.au](https://www.aer.gov.au/).

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

Submissions should be emailed to AERInquiry@aer.gov.au before 5pm on Tuesday 2 August 2016. Enquiries may be emailed to the same AER email address. Submissions may also be mailed to:

Mr Chris Pattas,

General Manager Networks

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.

# Summary

On 20 May 2016, Energex submitted an application for a waiver from the Queensland ring fencing guidelines in respect of a mobile educational exhibit incorporating solar photovoltaic (PV) installation and a Battery Energy Storage System (BESS).[[3]](#footnote-3) Section 1(b) of the Guidelines prevents a distribution network service provider (DNSP), such as Energex, 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.

After receiving Energex’s application, we posted it on our website and called for submissions from stakeholders via a notice in The Australian and an email notification. We received two submissions in response to this application.

Energex intends to undertake a number of BESS trials including a mobile, educational exhibit BESS trial. It described this trial as seeking to engage and educate customers about demand management, energy consumption and technology changes and their combined impact on the network and cost to serve. To assist with this, Energex has proposed to build a mobile exhibit incorporating solar PV, residential BESS, a Home Energy Management System (HEMS) and a number of typical home appliances (e.g. dishwasher, TV, clothes washer/dryer).

The use of solar PV panels and a BESS for the mobile educational exhibit falls within the definition of a "related business" in the Guidelines because it involves electricity generation and supply to the network, i.e. producing electricity. The waiver, if granted, would allow Energex to operate the project as a related activity.

We may grant a waiver from the Guidelines’ obligations if we consider the DNSP’s costs of complying with those obligations, in respect of undertaking a “related business”, would outweigh the public benefit.

The purpose of the current Guidelines is to prevent DNSPs from vertically integrating to provide electricity generation and retailing activities. The Guidelines do not account for the broader scope of considerations reflected in the AEMC’s recent work on energy storage, including market development issues.[[4]](#footnote-4) However, we are taking these issues into account in developing new national ring fencing guidelines, due by December 2016.[[5]](#footnote-5)

We received two submissions in response to Energex’s waiver application. Origin Energy submitted that the educational BESS project is uncontentious, while Red/Lumo Energy opposed granting a waiver. Red/Lumo Energy submitted that the AER should withhold granting a waiver until the new ring fencing guidelines are finalised. While we have noted the positions advanced by submissions, we are required to assess the ring fencing waiver application on the basis of existing regulatory arrangements and cannot defer consideration until the new ring fencing guidelines are made. We therefore consider that Red/Lumo Energy’s objections are not well founded in respect of the Queensland Ring Fencing Guidelines.

Energex submitted that it will not profit from the solar electricity generated as part of the exhibit as it is only producing electricity for the purposes of powering the demonstration appliances. Any excess generation exported to the network is expected to be negligible. Energex's waiver application is premised on the project not equating to the "business" of generating/supplying electricity. We note, however, there is an opportunity for Energex to sell electricity, particularly with the combination of PV and batteries used in the project. Therefore we consider it appropriate for Energex to submit a ring fencing waiver application for our assessment.

Having considered the material submitted by Energex, our draft decision is to grant a temporary and conditional waiver from section 1(b) of the Guidelines. The waiver is limited to the mobile, educational exhibit BESS trial described in Energex's waiver application. The waiver is conditional on Energex not selling electricity injected into the network. 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 this demonstration PV and BESS project, Energex 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.

# 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.[[6]](#footnote-6) 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 (Queensland) Guidelines to date.

## 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 a 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 31 May 2016, we published a notice in The Australian newspaper to seek comment on Energex's waiver application. We also published the waiver application on the AER website and issued an email alert to AER subscribers.

# Energex’s waiver application

The waiver sought by Energex 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 within that legal entity"

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

Section 21 allows the AER to waive the Guidelines' obligations if we consider the administrative costs of compliance will outweigh the public benefit. Section 22 of the Guidelines allows DNSPs to seek a notice from the AER to be issued under section 21.

## **Mobile educational exhibit**

Energex’s waiver application described its intention to undertake a number of BESS trials including a mobile, educational exhibit BESS trial for the purposes of engaging and educating customers about demand management, energy consumption and technology changes and their combined impact on the network and cost to service. To assist with this challenge, Energex has proposed to build a mobile educational exhibit incorporating solar PV, BESS, a Home Energy Management System (HEMS) and a number of typical home appliances (e.g. dishwasher, TV, clothes washer/dryer).

Energex explained that it will leverage off the current media platforms and public interest in new technologies such as BESS to commence the educational program through the development of a physical “house of the future”. A single mobile exhibit will be developed and used for educational purposes at locations such as the Brisbane Exhibition, Brisbane Home Show and other high profile public demonstration events. When not being used for educational purposes, the exhibit will reside at Energex’s Eagle Farm Distribution Centre. Energex also noted that it could use this opportunity to provide customers with information about upcoming tariff reform and how they might benefit by using technology to reduce their peak demand.

Energex has proposed to fund the educational exhibit through the Demand Management Innovation Allowance (DMIA) as proposed in Energex’s 2015-20 regulatory proposal.

Energex expects the amount of electricity exported into TradeCoast’s network to be negligible. The electricity generated from the solar PV panels is intended to power the appliances used as part of the exhibit only. Any electricity send into the network will not be sold.

## A related business

Energex submitted:[[7]](#footnote-7)

While the exhibit involves the generation of electricity from the solar PV panels and/or the withdrawal of electricity from the BESS, Energex does not consider this constitutes carrying on a related business. This is because Energex is not in the business of producing electricity as there is no intention to make a profit. Energex is only producing electricity for the purposes of powering the appliances as part of the exhibit.

## Costs of compliance with ring fencing obligations

For a ring fencing waiver to be granted, Energex must demonstrate that the administrative cost of complying with the ring fencing obligation outweighs the benefit, or any likely benefit, to the public. Energex submitted an estimate of its expected costs of ring fencing the Eagle Farm project with its waiver application. Energex has claimed commercial confidentiality over its cost estimates so we have not set them out here.

While the cost estimates submitted by Energex are not significant in comparison with Energex's revenues, they will ultimately be borne by Energex's customers as part of Energex’s standard control services through increases in network charges. Against these costs we must assess the potential benefit of requiring Energex to establish and ring fence a separate legal entity to undertake the development of the solar PV and BESS educational display. Our assessment of these costs and benefits must be in light of the Guideline's focus on a related business of producing electricity.

## Reasons for seeking a waiver

Energex submitted:[[8]](#footnote-8)

Energex considers the administrative costs of complying with section 1(b) outweigh the benefit or likely benefit to the public.

…

Energex does not consider that the establishment and operation of this solar PV/BESS educational display:

has any impact on the national electricity market given the negligible generation/export capacity of the solar PV installation;

constitutes entering the generation or retail markets; and

interferes in any way with Energex's legislative requirements.

# 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.

## Submissions

We received two submissions on Energex’s waiver application.[[9]](#footnote-9)

Origin Energy submitted: [[10]](#footnote-10)

Origin considers that the activity of an educational exhibit is uncontentious. However, Energex state that the installation may be potentially utilised at its Eagle Farm Distribution Centre on a semi-permanent basis. We believe more information is required regarding the nature of this utilisation before a waiver can be granted.

Red/Lumo Energy opposed granting a waiver for the project, submitting that:[[11]](#footnote-11)

* Energex has not provided sufficient transparency as to how the benefits of ring fencing to consumers are outweighed by its costs
* the waiver application should be considered under the new national ring fencing guidelines
* the project will be significantly detrimental to competitive markets
* DMIA funding should not be used for projects of this nature.

We note that similar concerns were raised in relation to the Energex ring fencing waiver application approved in March 2016.

## Our considerations

We accept that Energex’s educational exhibit incorporating solar PV and BESS is to be undertaken for the purposes of engaging and educating customers about demand management, energy consumption and technology changes and their impact on the network. Further, that Energex can use the opportunity to provide customers with information about upcoming tariff reform and how they might benefit by using technology to reduce their peak demand.

We also note that materiality is a consideration in the assessment of Energex’s application. As this is a small scale project in regard to the solar PV capacity and BESS installation, we do not consider that the project will be sufficiently material to cause issue. Any electricity exported into Energex’s embedded network, owned by TradeCoast, is expected to be negligible and therefore insignificant at the network level.

The development of the mobile educational exhibit will not be undertaken for business purposes, in that Energex will not sell any electricity into the network and does not intend to make a profit. While the Guidelines do not define what a "business" is, as a general principle we accept that a business activity is normally undertaken to achieve a positive financial return. Nevertheless, the Guidelines could be interpreted such that Energex would be captured by the ring fencing requirements. For this reason we consider it is appropriate that Energex seek a waiver for the project.

We note Red/Lumo Energy’s proposal that we should assess Energex’s waiver application under new national ring fencing guidelines rather than under the existing Queensland Ring Fencing Guidelines. We consider it would not be reasonable to delay consideration of the waiver request for several months. Moreover, the Queensland Ring Fencing Guidelines continue to have effect until they are replaced. Were we to postpone our consideration of Energex’s waiver application we would be in breach of the regulatory framework we are required to administer.

With respect to Origin Energy’s proposal that more information is required, we consider the available information sufficiently illustrates the key issues for our decision on Energex’s waiver application. We accept that the primary purpose of the demonstration asset is educational and that Energex will not earn revenue from electricity generated by the project. It’s unclear what further information could materially influence our decision on Energex’s waiver request.

Energex has proposed to fund the exhibit through its DMIA resources. We do not see anything to prevent this. Energex will be required to submit to us a DMIA report summarising outcomes from the project. We encourage Energex to share further details with the broader energy sector through industry conferences and the like. The project's results should provide insight to stakeholders of the impact batteries can have on networks.

We consider that the Guidelines do not contemplate competitive neutrality and broader market contestability issues that have been raised by stakeholders in previous ring fencing waiver applications. As explained by the QCA in its final decision on the existing Guidelines:[[12]](#footnote-12)

…the Authority’s objective for the Guidelines is to assist in creating an environment where the price, quantity and quality of electricity traded in the retail market, and the price, quantity and quality of distribution services used to deliver the energy, are not uneconomically biased by the vertical integration of distribution and other businesses…

We recognise that the potential provision of services from batteries will be subject to further consideration as part of the development of our ring fencing guidelines and will also be informed by any further policy direction from the COAG Energy Council and the Australian Energy Market Commission (AEMC).[[13]](#footnote-13) We hold the view that contestable services should be provided in competitive markets. Networks should not be able to leverage off their monopoly business activities to gain an advantage in competitive markets. These issues will be a focus of our consultation in developing new national guidelines.

As required by the current Guidelines, for Energex's waiver application we have considered the likely benefit to the public of enforcing the current ring fencing provisions against Energex's submitted cost estimates. To the extent that Energex's mobile educational exhibit could be considered to be a related business as defined by the Guidelines, we consider it unlikely that there will be material benefits to consumers from requiring Energex to undertake ring fencing in this instance. So even though the administrative costs of Energex ring fencing the project would be relatively minor compared to Energex's total revenues, they outweigh any potential benefit.

## 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 Energex not selling electricity injected into the network by the mobile educational exhibit.

Energex 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.

1. By Queensland Competition Authority. [↑](#footnote-ref-1)
2. Queensland Competition Authority, Electricity Distribution Ring–Fencing Guidelines, September 2000. [↑](#footnote-ref-2)
3. Energex, Energex application for a ring fencing waiver under the electricity distribution ring fencing guidelines, May 2016. [↑](#footnote-ref-3)
4. AEMC, *Final report — Integration of Storage: Regulatory Implications,* December 2015. [↑](#footnote-ref-4)
5. AER, *Ring-Fencing Guideline – Preliminary Positions Paper*, April 2016. [↑](#footnote-ref-5)
6. Queensland Competition Authority, Final Determination: Electricity Distribution: Ring Fencing Guidelines, September 2000, p.8. [↑](#footnote-ref-6)
7. Energex, Energex application for a ring fencing waiver under the electricity distribution ring fencing guidelines, May 2016, p.2. [↑](#footnote-ref-7)
8. Energex, Energex application for a ring fencing waiver under the electricity distribution ring fencing guidelines, May 2016, p.2. [↑](#footnote-ref-8)
9. Submissions are available to view on the [AER website](https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/ring-fencing-waivers) (www.aer.gov.au). [↑](#footnote-ref-9)
10. Origin Energy, *Re. Submission to Energex application for a ring fencing waiver*, June 2016, p. 1. [↑](#footnote-ref-10)
11. Red Energy and Lumo Energy, *Re Energex ring fencing waiver application – Educational BESS project*, June 2016. [↑](#footnote-ref-11)
12. QCA, *Final determinations—Electricity distribution: ring fencing guidelines,* September 2000, p.2. [↑](#footnote-ref-12)
13. AER, *Ring-Fencing Guideline – Preliminary Positions Paper*, April 2016. [↑](#footnote-ref-13)