

Final Decision

Ergon Energy application for waiver from Queensland Ring Fencing Guidelines

February 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 |
| 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]](#footnote-2) |

# Summary

The current waiver application was submitted by Ergon Energy on 29 October 2015 for its Grid Utility Storage System (GUSS) units. We are required to assess this application under the Queensland Electricity Distribution: Ring Fencing Guidelines (Queensland Guidelines) which were developed by the Queensland Competition Authority in 2000. Section 1(b) of the Queensland Guidelines prevents a Distribution Network Service 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 stated that its GUSS units use smart technology coupled with energy storage. GUSS units fall within the definition of a "related business" because they inject electricity into the network. i.e. they produce electricity.

The waiver, if granted, would allow Ergon Energy to own and operate the GUSS units as a related activity. We may grant a waiver from the Queensland 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 Queensland Guidelines is to prevent the Queensland DNSPs, Ergon Energy and Energex, from vertically integrating to provide electricity generation and retailing activities. The Queensland Guidelines do not account for the broader scope of considerations reflected in the AEMC's recent work on energy storage, including market development issues.[[2]](#footnote-3) Some submissions have, understandably, raised those issues in respect of Ergon Energy's current waiver application.[[3]](#footnote-4)

Most submissions opposed granting Ergon Energy a waiver because, they argued, DNSPs should not provide energy storage services.[[4]](#footnote-5) Rather, such services should be purchased from third party providers or from customers operating batteries on the customer’s side of the meter.

One submission supported granting a waiver—Western Power submitted that ring fencing arrangements should not inhibit network businesses from undertaking efficient investment.[[5]](#footnote-6)

While we have noted the positions advanced by submissions it would be premature for us to make a decision based on such considerations. We have considered Ergon Energy's current waiver application with respect to the Queensland Guidelines, as we are required to do. We will take market contestability issues into account in developing new national ring fencing guidelines during 2016. We will begin to publicly consult on the new national guidelines in coming weeks.

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

Having considered materials submitted by Ergon Energy, submissions provided in response to its ring fencing application and submissions provided in response to our draft decision, our final decision is to grant a temporary waiver from section 1(b) of the Guidelines. We accept that Ergon Energy’s GUSS units will operate only to provide network support and will not produce electricity for financial benefit. In the context of undertaking a ”related business” we agree that the costs of not granting a waiver to Ergon Energy outweigh the possible benefits.

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, including the existing Queensland Guidelines. In respect of these 20 GUSS units, Ergon Energy will be required to comply with the new guidelines within 12 months of them being established, or comply with any transitional provisions for existing waivers that are set out in the new guidelines.

# Queensland Ring Fencing Guidelines

The QCA published the Queensland Guidelines in September 2000. The objective of the guidelines is to provide an environment in which the price, quantity and quality of electricity traded in the retail, generation and wholesale markets is not influenced by vertical integration between distribution and other businesses.[[6]](#footnote-7) The Queensland 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 might outweigh the likely benefit to the public.

On 1 July 2010 the AER assumed responsibility for administering the Queensland 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.

## Procedure for waiving ring fencing obligations

Section 1 of the Queensland 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 Queensland Guidelines in assessing the application.

On 20 November 2015 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 four submissions on Ergon Energy's waiver application. We subsequently published our draft decision on 17 December 2015 and again invited submissions. We received a further four submissions on our draft decision.

# Ergon Energy’s waiver application

The waiver sought by Ergon Energy is in regard to section 1(b) of the Queensland 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 Queensland Guidelines as a business of producing, purchasing or selling electricity.

## ****GUSS units****

Ergon Energy’s waiver application identified a need to provide SWER assets with network support. Ergon Energy has 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 during peaks in demand, Ergon Energy submitted that the GUSS units will allow augex to be postponed or avoided.

Ergon Energy’s waiver application indicated that two GUSS units have already 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 polies and wires, would cost $20.1 million.[[7]](#footnote-8)

## A related business

Ergon Energy submitted:[[8]](#footnote-9)

"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
* 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."

## 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 that, 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.[[9]](#footnote-10) As Ergon Energy submitted its cost estimates on a confidential basis we have not detailed them here.

We have taken those proposed costs into account in considering Ergon Energy's waiver application.

## 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.[[10]](#footnote-11) 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.[[11]](#footnote-12)

# Our assessment

As set out above, we may waive a ring-fencing requirement if we are 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 four submissions on our draft decision on Ergon Energy's waiver application, all of which are available to view on the AER website.

Three of the four submissions opposed granting Ergon Energy a waiver:

* The Public Interest Advocacy Centre (PIAC) submitted that network businesses should be excluded from owning battery technology.[[12]](#footnote-13)
* Mr John Herbst submitted that Ergon Energy's GUSS units are less cost effective than consumer owned batteries or moving remote communities off the grid.[[13]](#footnote-14) Mr Herbst further noted that another network business (United Energy) has commented positively on the potential for consumer owned batteries to provide network support services.
* Energy Consumers Australia (ECA) submitted that Ergon Energy should be required to source battery services from third parties.[[14]](#footnote-15) The ECA also commented that our draft decision to grant a waiver was incorrectly premised on the view that Ergon Energy would not be selling electricity injected into the grid from its GUSS units. Rather, that the electricity would be sold at zero cost.

One submission supported Ergon Energy's waiver application:

* Western Power submitted that prescribing onerous ring fencing requirements may undermine a network providers' ability to select the most efficient option for network investment.[[15]](#footnote-16) Western Power further proposed that a full review of the potential for market failure should be undertaken before a regulatory decision is made to intervene.

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

## Our considerations

We accept that Ergon Energy’s GUSS units will operate only to provide network support and will not engage in electricity production for financial benefit. Ergon Energy is not proposing to enter the wholesale market for electricity. In the context of the Queensland Guidelines there are unlikely to be any benefits from not waiving the ring fencing requirements in this case. However, we accept that Ergon Energy would incur administrative costs in complying with the ring fencing requirements. Therefore, we consider the possible benefits from enforcing ring fencing requirements on Ergon Energy are outweighed by the costs it would incur in undertaking ring fencing. Consistent with our draft decision, our final decision is to grant a waiver from section 1(b) of the Queensland Guidelines.

While we note the ECA's comments regarding the supply of electricity at zero cost, we do not consider that the ECA's premise is sustainable in this context. The Queensland Guidelines were developed by the QCA to maintain separation of the provision of network services from generation and retail activities. Ergon Energy's undertaking to inject electricity from its GUSS units into the network free of charge does not equate to the business of producing electricity such as would be undertaken by a generator. We further note that new national ring fencing guidelines are unlikely to be as narrowly focussed as the current Queensland Guidelines.

We note comments in submissions from the ECA, PIAC and Mr Herbst that it may be appropriate for DNSPs to source network storage services from third parties. This may particularly be the case if they intend to arbitrage in the wholesale market between high price and low price periods. However, we must limit our considerations to the issues set out by the Guidelines. That is, whether or not Ergon Energy's GUSS units will equate to the business of producing electricity. In this instance, because Ergon Energy has confirmed it will not sell electricity injected into the network, we maintain our view from our draft decision that it is appropriate to grant a waiver. It is also appropriate that the waiver be temporary given the coming establishment of new national ring fencing guidelines. 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 and competitive neutrality issues raised in submissions, we consider that the Queensland Guidelines do not contemplate these issues. We recognise that the potential provision of services from batteries will be subject to further policy direction from the COAG Energy Council and the Australian Energy Market Commission (AEMC). This will factor in our development of new national ring fencing guidelines.

As we commented in our draft decision, 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]](#footnote-17) 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]](#footnote-18) 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.

We will develop new national ring fencing guidelines over the 2016 calendar year.

## Our final decision

For the above reasons we consider granting a temporary and conditional waiver is appropriate. Our final decision, consistent with our draft decision, is to grant a temporary waiver from section 1(b) of the Queensland 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.

1. By Queensland Competition Authority. [↑](#footnote-ref-2)
2. AEMC, Final report — Integration of Storage: Regulatory Implications, December 2015. [↑](#footnote-ref-3)
3. Submissions are briefly summarised in section 4.1 of this paper and are available to view at the AER website [www.aer.gov.au](https://www.aer.gov.au/) [↑](#footnote-ref-4)
4. PIAC, Ergon Energy application for ring fencing waiver, 21 January 2016; Mr John Herbst, Response to Ergon Energy ring fencing draft decision, 22 January 2016; Energy Consumers Australia, Ergon application for ring fencing waiver - submission on draft decision, January 2016. [↑](#footnote-ref-5)
5. Western Power, Ergon Energy ring fencing waiver application - AER draft decision, 21 January 2016. [↑](#footnote-ref-6)
6. Queensland Competition Authority, Final Determination: Electricity Distribution: Ring-Fencing Guidelines, September 2000, p.8. [↑](#footnote-ref-7)
7. Ergon Energy, Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines, p. 2. [↑](#footnote-ref-8)
8. Ergon Energy, Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines, pp. 5–6. [↑](#footnote-ref-9)
9. Ergon Energy, Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines, Confidential Appendix 1. [↑](#footnote-ref-10)
10. Ergon Energy, Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines, p. 6. [↑](#footnote-ref-11)
11. Ergon Energy, Application for ring fencing waiver under s.21 of the electricity distribution ring fencing guidelines, p. 7. [↑](#footnote-ref-12)
12. PIAC, Ergon Energy application for ring fencing waiver, 21 January 2016. [↑](#footnote-ref-13)
13. Mr John Herbst, Response to Ergon Energy ring fencing draft decision, 22 January 2016. [↑](#footnote-ref-14)
14. Energy Consumers Australia, Ergon application for ring fencing waiver - submission on draft decision, January 2016. [↑](#footnote-ref-15)
15. Western Power, Ergon Energy ring fencing waiver application - AER draft decision, 21 January 2016. [↑](#footnote-ref-16)
16. AEMC, Final report — Integration of Storage: Regulatory Implications, December 2015. [↑](#footnote-ref-17)
17. AEMC, Final report — Integration of Storage: Regulatory Implications, December 2015, p. iv. [↑](#footnote-ref-18)