



Draft Decision

**Ergon Energy**

**Application for Waiver from  
Ring-Fencing Guidelines**

April 2011

© Commonwealth of Australia 2011

This work is copyright. Apart from any use permitted by the Copyright Act 1968, no part may be reproduced without permission of the Australian Competition and Consumer Commission. Requests and inquiries concerning reproduction and rights should be addressed to the Director Publishing, Australian Competition and Consumer Commission, GPO Box 3131, Canberra ACT 2601.

# Contents

<b>Shortened forms .....</b>	<b>iv</b>
<b>Request for submissions .....</b>	<b>v</b>
<b>Summary.....</b>	<b>vi</b>
<b>1 Queensland Ring-Fencing Guidelines.....</b>	<b>1</b>
1.1 Procedure for waiving ring-fencing obligations .....	1
<b>2 Ergon Energy’s wavier application .....</b>	<b>3</b>
2.1 Corporate responsibility.....	3
2.2 Costs of compliance with ring-fencing obligations .....	4
2.3 Related Markets and Vertical Integration .....	4
<b>3 AER’s assessment .....</b>	<b>5</b>
3.1 AER’s considerations.....	5
3.2 AER’s draft decision.....	6

## Shortened forms

Shortened form	Extended form
ACCC	Australian Competition and Consumer Commission
AER	Australian Energy Regulator
Climate Change Strategy 2007	ClimateSmart 2050: Queensland Climate Change Strategy 2007: a low carbon future
DNSP	Distribution Network Service Provider
Ergon Energy	Ergon Energy Corporation Limited
Government Owned Corporation	GOC
NER	National Electricity Rules
QCA	Queensland Competition Authority
Ring-fencing Guidelines	Queensland Competition Authority's Electricity Distribution: Ring-Fencing Guidelines, September 2000

## Request for submissions

This document sets out the Australian Energy Regulator's (AER) draft decision in respect of Ergon Energy Corporation Limited (Ergon Energy)'s application for a waiver from the Queensland Competition Authority's Ring-Fencing Guidelines, September 2000 (the Guidelines). Ergon Energy's waiver application relates to a requirement under section 1(b) of the Ring-Fencing Guidelines not to carry on a related business within its legal entity. Interested parties are invited to make written submissions on this draft decision to the AER by 5 pm A.E.S.T on Friday, 6 May 2011.

The AER will consider all information it receives in accordance with the ACCC/AER information policy, and will make a final decision on Ergon Energy's application. The policy is available at [www.aer.gov.au](http://www.aer.gov.au).

Submissions can be sent electronically to [AERInquiry@er.gov.au](mailto:AERInquiry@er.gov.au).

Alternatively, submissions can be mailed to:

Mr Warwick Anderson  
General Manager  
Network Regulation  
Australian Energy Regulator  
GPO Box 3131  
Canberra ACT 2601

The AER prefers that 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. Copies of Ergon Energy's waiver application and other relevant material are available on the AER's website.

Inquiries about this draft decision or how to make submissions can be made by email to [AERInquiry@er.gov.au](mailto:AERInquiry@er.gov.au).

## Summary

On 16 March 2010, Ergon Energy applied to the AER for a waiver from its ring-fencing obligations. Section 1(b) of the Ring-fencing Guidelines prevents a Distribution Network Services Provider (DNSP) from carrying on a 'related business' within its legal entity. A 'related business' means a business of producing, purchasing or selling electricity.

Since 2008, Ergon Energy has installed nine solar photovoltaic (PV) systems and has proposed to install seven more on its building in 2011. The PV installations on Ergon Energy's buildings fall within the definition of a 'related business' under the Guidelines as they produce electricity. The waiver, if granted, would allow Ergon Energy to own and operate the PV systems as a related business.

Having considered Ergon Energy's waiver application, the provisions of the Guidelines and the National Electricity Rules (NER), the AER has made a draft decision to approve Ergon Energy's application. However, the AER has also decided that the total electricity generation capacity of all Ergon Energy's PV installations combined be capped at a maximum limit of 300 kilowatts.

# 1 Queensland Ring-Fencing Guidelines

The Queensland Competition Authority (QCA) published its Ring-fencing Guidelines in September 2000. The objective of the Guidelines 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<sup>1</sup>. At the same time, the Guidelines recognised the potential for capturing activities where the cost imposed by complying with the ring-fencing obligations could outweigh the benefit, or any likely benefit, to the public<sup>2</sup>.

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.

## 1.1 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, which states:

“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<sup>3</sup> 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. The table below sets out this procedure.

**Table 1.1: Timetable for assessing Ergon Energy's waiver application**

Event	Date
Waiver application received from Ergon Energy	16 March
Notice of application published	30 March
Submissions on application due	13 April
AER's draft decision released	21 April
Submissions on the draft decision due	6 May
AER's final decision released	late May

<sup>1</sup> Queensland Competition Authority, *Final Determination: Electricity Distribution: Ring-Fencing Guidelines*, September 2000, p.8.

<sup>2</sup> Ibid.

<sup>3</sup> The word 'associates' is defined in sections 10-17 of the *Corporations Law 2001* (Commonwealth).

On 30 March 2011, the AER published a notice in *The Australian* newspaper to seek comment from interested parties on Ergon Energy's waiver application. No submissions were received by the AER.



## 2 Ergon Energy's waiver application

On 16 March 2011, Ergon Energy applied to the AER for a waiver relating to the ownership and operation of all existing and proposed PV installations on its buildings. The PV installations use solar cells to convert energy from the sun into electricity and therefore fall within the definition of a 'related business' under the Guidelines.

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

“A Distribution Network Service Provider 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.

In Appendix 1 of its waiver application, Ergon Energy identified 16 PV installations: nine existing PV systems (the first installed in 2008) and seven proposed PV installations (all due for completion during 2011). Moreover, Ergon Energy has sought a waiver in respect of all future PV installations for its depot and office portfolios.<sup>4</sup>

### 2.1 Corporate responsibility

Ergon Energy has stated that its PV installations are implemented in response to the Queensland Government's \$414 million program to tackle climate change – *ClimateSmart 2050: Queensland Climate Change Strategy 2007: a low carbon future*<sup>5</sup> (Climate Change Strategy 2007). The initiatives that came out of the program include the following:

- all Queensland government buildings be carbon-neutral by 2020 and achieve four-and-a-half-star energy efficiency ratings
- investment programs for renewable and low-emission technologies
- \$7.25 million ClimateSmart Homes rebates

As a Government Owned Corporation (GOC), Ergon Energy announced that it intended to support the Queensland Government's Climate Change Strategy 2007. In order to meet the energy efficiency targets, Ergon Energy has been installing PV systems in all of its refurbishment and new building constructions.

---

<sup>4</sup> Ergon Energy, *Application for a ring-fencing waiver under section 21 of the electricity distribution: Ring-Fencing Guidelines*, 16 March 2011, p.1.

<sup>5</sup> [http://www.thepremier.qld.gov.au/library/pdf/initiatives/climate\\_change/ClimateSmart\\_2050.pdf](http://www.thepremier.qld.gov.au/library/pdf/initiatives/climate_change/ClimateSmart_2050.pdf)

## **2.2 Costs of compliance with ring-fencing obligations**

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

Ergon Energy submitted that compliance, which involved creating a separate company to own and operate the PV systems, would not provide any public benefit. On the other hand, Ergon Energy estimated that the establishment costs of a new subsidiary company and the annual operating costs of the PV systems would amount to \$11,700 and \$157,000 respectively. In addition, Ergon Energy pointed out that the creation of another GOC company would likely to involve a lengthy consultation process under *Government Owned Corporations Act 1993*.

## **2.3 Related Markets and Vertical Integration**

In addition, Ergon Energy considered that the installation of PV on its buildings:

- would not have an impact on the National Electricity Market
- would not result in Ergon Energy entering the generation or retail markets, despite any excess generation going into the grid
- was not of significant capacity such that it would be construed to be re-integrating the electricity industry functions

### **3 AER's assessment**

The AER does not consider that Ergon Energy's waiver application has been made on trivial or vexatious grounds<sup>6</sup>. Consequently, the AER is now issuing its draft decision in accordance with section 26 of the Guidelines.

Section 21 of the Guidelines provides that the AER may waive a ring-fencing requirement if it is satisfied that the administrative cost to the DNSP in complying with the ring-fencing obligations outweigh the benefit, or any likely benefit, to the public.

#### **3.1 AER's considerations**

The AER broadly accepts Ergon Energy's submission that the administrative cost of compliance would outweigh any apparent public benefit.

As a general rule, the AER considers the requirement of legal separation as a necessary aspect of its regulation of distribution businesses. It is particularly important for the effective separation of any upstream and downstream business activities from the monopoly business, and the elimination of cross-subsidies and incentives to undertake anti-competitive behaviour.

However, having considered Ergon Energy's arguments, the AER accepts that the costs of complying with the ring-fencing obligations (for example, the legal establishment fees and annual finance and company management costs) would outweigh any public benefit of that compliance.

The AER considers that there would be no apparent public benefit from requiring Ergon Energy to establish a separate legal entity to own and operate the PV systems. The PV systems are not being used by Ergon Energy to enter either the generation or retail markets and, as a result, are unlikely to have any negative impact on the competitive outcomes in these markets to the public detriment. Moreover, the AER is of the view that installation of PV systems by a DNSP should be encouraged, insofar as these initiatives fall within its corporate responsibilities.

The AER considers that a waiver should be granted in respect of Ergon Energy's ring-fencing obligations for the nine existing PV installations and the seven PVs systems that are proposed to be installed this year.

However, the AER is not satisfied that the waiver should be so opened ended as to include any number of future PV installations as contemplated by Ergon Energy. There could be risks in providing an open-ended approval to own and operate PV installations, as there is no guarantee that such systems would operate along the same lines as those subject to this waiver application. Consequently, the AER proposes to grant a waiver such that the total electricity generation capacity of all Ergon Energy's PV systems be capped at a maximum limit of 300 kilowatts. This cap is inclusive of the 16 PV installations identified in Ergon Energy's application that have a combined

---

<sup>6</sup> Section 23(a) of the Guidelines states that if the QCA considers the application has been made on trivial or vexatious grounds, the QCA must reject the application without further consideration.

capacity of 112.7 kilowatts. PV installations that would result in the limit being exceeded would require a further waiver application by Ergon Energy.

The AER reserves the right to vary, revoke or amend this waiver in respect of any future PV installations.

Ergon Energy's other activities will remain subject to all other aspects of the Guidelines and section 1(b) will continue to apply to any other relevant activities of Ergon Energy.

### **3.2 AER's draft decision**

The AER proposes to issue a notice under section 21 of the Guidelines to waive Ergon Energy's obligation to comply with section 1(b) of the Guidelines. This waiver will apply to PV systems with a combined generation limit of 300 kilowatts. As such, the waiver will extend to the 16 PV installations identified in Ergon Energy's application. Ergon Energy may choose to install more PVs in the future, subject to the combined capped limit.

The AER reserves the right to vary, revoke or amend this waiver in respect of any future PVs.

The AER invites interested parties to make written submissions on this draft decision to the AER by 5 pm A.E.S.T on Friday, 6 May 2011.