



Draft Decision

**Ergon Energy**  
**Application for Waiver from Ring-fencing**  
**Guidelines**

March 2014

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## Shortened forms

Shortened form	Extended form
ACCC	Australian Competition and Consumer Commission
AER	Australian Energy Regulator
DNSP	Distribution Network Service Provider
Ergon Energy	Ergon Energy Corporation Limited
GOC	Government Owned Corporation
Guidelines	(Queensland) Electricity Distribution Ring-Fencing Guidelines, September 2000
NEL	National Electricity Law
NER	National Electricity Rules
QCA	Queensland Competition Authority

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## Request for submissions

The Australian Energy Regulator (AER) has made its draft decision on Ergon Energy's application for a waiver of obligations under section 1(b) of the (Queensland) Electricity Distribution Ring-Fencing Guidelines, September 2000 (Guidelines). Ergon Energy, a Distribution Network Service Provider (DNSP) in Queensland, is seeking a waiver to allow the ownership and operation of a 1MVA grid-connected generator constructed by Ergon Energy for network support in the Mount Isa region. Ergon Energy justified its application for a waiver of the obligations in section 1(b) on the basis that the cost of complying with the obligations outweighs the public benefit of compliance.

Interested parties are invited to make written submissions on this draft decision to the AER by the close of business on Monday, 31 March 2014. Submissions can be sent electronically to [AERInquiry@aer.gov.au](mailto:AERInquiry@aer.gov.au).

Alternatively, submissions can be mailed to:

Mr Chris Pattas  
General Manager  
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Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3001

The AER will consider all information it receives in accordance with the ACCC/AER information policy. The policy is available at [www.aer.gov.au](http://www.aer.gov.au).

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.

Enquiries about this draft decision, or about lodging submissions, can be made by email to [AERInquiry@aer.gov.au](mailto:AERInquiry@aer.gov.au).

## Summary

On 17 January 2014, Ergon Energy applied to the AER for a waiver from the ring-fencing obligations set out in section 1(b) of the Guidelines. Section 1(b) of the Guidelines provides that a DNSP must not carry on a related business within that legal entity. A related business is defined as the business of producing, purchasing or selling electricity.

Ergon Energy's waiver application, if granted, would allow Ergon Energy to own and operate a 1MVA grid-connected generation unit in the Mount Isa region for network support purposes. Ergon Energy submitted that it was required to construct the generation unit to avoid potential load shedding for the 2013-14 summer following the failure of negotiations for contracted third party network support services.

Having considered Ergon Energy's application, we have made a draft decision to waive Ergon Energy's requirement to comply with section 1(b) of the Guidelines with respect to its Mount Isa network support generator. We consider that the benefit, or likely benefit, to the public of compliance is outweighed by the administrative cost to Ergon Energy of complying with the ring-fencing obligation.

# 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. 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.

The AER now administers the Guidelines under clause 11.14.5(b)(3) of the NER. The Guidelines separate the accounting and functional aspects of ring-fenced services from other services provided by Ergon Energy. Ring-fencing obligations include the requirement that a DNSP:

- not carry on a related business
- maintain a separate set of accounts in respect of the prescribed distribution services
- allocate any shared costs between ring-fenced services and any other activity in a manner that ensures there is no cross subsidy and in accordance to a methodology approved by the QCA
- not provide distribution network access to a related business on more favourable terms than those it provides to any other customer.

## 1.1 Procedure for waiving ring-fencing obligations

Section 1 of the Guidelines sets out the minimum ring-fencing obligations imposed on Ergon Energy. Ergon Energy has the right under section 22 of the Guidelines to seek a waiver from these obligations by requesting the AER issue a notice under section 21. Section 21 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 of complying with the obligation outweighs the benefit, or likely benefit, to the public.

Where a DNSP applies for a waiver from requirements of the Guidelines, we must follow the consultation procedure set out in sections 23 to 30 of the Guidelines in assessing the application. The table below sets out this procedure.

**Table 1: Timetable for assessing Ergon Energy's waiver application**

Event	Date
Waiver application received from Ergon Energy	17 January 2014
Notice of application released	30 January 2014
Submissions on application due	14 February 2014
AER's draft decision	7 March 2014
Submissions on the draft decision due	31 March 2014
AER's final decision released	22 April 2014

On 30 January 2014, we published Ergon Energy's waiver application and sought submissions from interested parties. No submissions were received.

## 2 Ergon Energy's waiver application

On 17 January 2014, Ergon Energy applied to the AER for a waiver from the ring-fencing Guidelines requirement that a DNSP not carry on a related business within the legal entity that provides ring-fenced services. A 'related business' is defined in the Guidelines as the business of producing, purchasing or selling electricity.

Ergon Energy is seeking a waiver of these obligations in relation to the ownership and operation of a grid-connected generation unit in the Mount Isa region. The 1MVA generation unit is to be used for network support purposes to alleviate identified network constraints in that region.

Ergon Energy submitted that the cost of complying with the obligations imposed by section 1(b) of the Guideline would not deliver any significant benefit. Ergon Energy also submitted that its proposed network support generation option complies with the provisions and intent of Queensland legislation, particularly its obligations under the *Electricity Act 1994* (Qld) (Electricity Act) and Electricity Regulations. Ergon Energy stated that its network support will not result in Ergon Energy entering the generation or retail markets for electricity. Ergon Energy submitted that its network support is consistent with the objectives of the Guideline.

### 2.1 Public benefit and administrative cost of 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.

In order to comply with the Guidelines, Ergon Energy submitted that it would be necessary to establish a separate subsidiary company to own and operate small generation assets. Ergon Energy considered that there is no additional public benefit in establishing a separate legal entity to house network support generating units, as opposed to those units being owned by Ergon Energy directly.

Conversely, Ergon Energy estimated the establishment and annual management costs for a Government Owned Corporation (GOC) to house the embedded generation assets to be \$13,000 and \$174,500 respectively. As these costs relate to the delivery of standard control services, these costs would necessarily be passed on to customers.

### 2.2 Legislative considerations

In addition to the direct administrative costs of establishing a separate subsidiary company, Ergon Energy submitted that its application should be considered in conjunction with an examination of the historical treatment of similar assets, other statutory instruments, the commercial and political environment which impact Ergon Energy's generation activities, and the emergency contingency requirements for the Mount Isa region.

Ergon Energy submitted that section 42(b) of the Electricity Act requires Ergon Energy to maintain a reliable supply of electricity to its customers. In certain situations the most technically and economically efficient response is to have generation available to supply customers rather than augmenting or replacing existing networks. This is recognised in the conditions of Ergon Energy's Distribution Authority, which enable it to use generation to fulfil its obligation to supply energy. Ergon Energy also submitted that section 42(d) of the Electricity Act requires it to consider both demand and supply side solutions to provide, as far as technically and economically practicable, for the efficient supply of electricity.



## 2.3 Related markets and vertical integration

Ergon Energy submitted that its network support generator at Mount Isa will:

- not have an impact on the National Electricity Market
- not result in Ergon Energy entering the generation or retail markets
- not be of sufficient capacity such that it could be construed to be re-integrating electricity industry functions.

## 3 AER's assessment

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

### 3.1 AER's considerations

We accept Ergon Energy's submission that the administrative cost of complying with the obligations under section 1(b) of the Guidelines outweighs the public benefit of compliance in respect of network support generation in the Mount Isa region.

As a general rule, we consider the requirement of legal separation as a necessary aspect of the regulation of network 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, each ring-fencing waiver application should be evaluated on its merits. We accept that Ergon Energy will incur some administrative costs in complying with section 1(b) of the Guidelines. These costs are not substantial in the context of the total costs of Ergon Energy's distribution business. However, they would nonetheless be reflected in distribution tariffs.

We further consider that there would be no apparent public benefit from establishing a separate legal entity to house the network support generating units. The 1MVA generating unit for network support located at Mount Isa will not be used to enter the National Electricity Market or retail markets. Therefore, it is unlikely to have any negative impact on competitive outcomes in these markets. The generating unit is to be used solely to provide distribution services. The consideration of efficient non-network solutions to provide distribution services is in the long term interests of electricity consumers. This is because, in appropriate circumstances, non-network solutions may produce a similar outcome to network augmentation at a lower cost, or defer costs. In this case, Ergon Energy's embedded generation solution seems likely to assist in deferring the need for network augmentation in this area for at least three years until 2016-17.

Having considered Ergon Energy's application, we consider that requiring Ergon Energy to comply with the legal separation requirements of section 1(b) of the Guidelines in this particular case would not achieve a public benefit sufficient to offset Ergon Energy's administrative costs. Rather, we consider that Ergon Energy's decision to utilise network support generation in Mount Isa, in preference to augmenting the distribution network, would potentially reduce costs to consumers.

The network support generator at Mount Isa will remain subject to all other provisions of the Guidelines.

### 3.2 AER's draft decision

We propose to issue a notice under section 21 of the Guidelines to waive Ergon Energy's obligations to comply with section 1(b). This waiver will apply to the 1MVA generation unit constructed by Ergon Energy for network support purposes in the Mt Isa region.

We invite interested parties to make written submissions on this draft decision by close of business on 31 March 2014.