



Final Decision

Ergon Energy
Application for Waiver from Ring-fencing
Guidelines

April 2014

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
DNSP	Distribution Network Service Provider
Ergon Energy	Ergon Energy Corporation Limited
Guidelines	(Queensland) Electricity Distribution Ring-Fencing Guidelines, September 2000
NER	National Electricity Rules
QCA	Queensland Competition Authority

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.¹ 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.

The waiver sought by Ergon Energy would allow it 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 released a draft decision on 7 March 2014.² The draft decision indicated our intention to issue a notice 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 concluded 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.

This final decision confirms our position as set out in the draft decision. We consider that the benefit, or likely benefit, to the public of compliance with section 1(b) of the Guidelines in this case is outweighed by the administrative cost to Ergon Energy of complying with the ring-fencing obligation. There is no public benefit in requiring Ergon Energy to establish a separate legal entity to house the network support generating unit. In contrast, the waiver will facilitate the adoption of a non-network solution in preference to augmenting the distribution network, and reduce costs to consumers.

¹ Ergon Energy, *Application for a ring-fencing waiver under section 21 of the electricity distribution ring-fencing guidelines*, 17 January 2014.

² AER, *Draft decision, Ergon Energy - Application for waiver from ring fencing guidelines*, March 2014.

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.³ 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.⁴

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 may, under section 22 of the Guidelines, 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	17 April 2014

³ QCA, *Final Determination: Electricity Distribution Ring-fencing Guidelines*, September 2000, p. 8.

⁴ QCA, *Final Determination: Electricity Distribution Ring-fencing Guidelines*, September 2000, p. 16.

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 sought 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. The Mount Isa distribution network is an isolated network, not physically connected to the National Electricity Market.

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.

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

3 AER's draft decision

The AER released its draft decision on Ergon Energy's ring-fencing waiver application on 7 March 2014. In the draft decision, we accepted 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 the Mount Isa network support generator.

We accepted that Ergon Energy would 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.⁵

We further considered that there would be no 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 2016-17.⁶

Having considered Ergon Energy's application, we concluded 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, 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.⁷

We sought submissions on our draft decision from interested parties. No submissions were received.

⁵ AER, Draft decision, *Ergon Energy - Application for waiver from ring fencing guidelines*, March 2014, p. 10.

⁶ AER, Draft decision, *Ergon Energy - Application for waiver from ring fencing guidelines*, March 2014, p. 10.

⁷ AER, Draft decision, *Ergon Energy - Application for waiver from ring fencing guidelines*, March 2014, p. 10.

4 AER's final decision

The AER's final decision is to issue a notice to waive Ergon Energy's obligation to comply with section 1(b) of the Guidelines in respect of the Mount Isa network support generator. In this case, we consider there is no public benefit in requiring Ergon Energy to comply with its ring-fencing obligations under section 1(b) of the Guidelines. Consistent with our draft decision, we accept Ergon Energy's submission that the administrative cost of complying with the ring-fencing obligation outweighs the benefit, or any likely benefit, to the public of compliance.

The AER will issue a notice under section 21 of the Guidelines to waive Ergon Energy's obligation to comply with section 1(b) of the Guidelines in respect of the 1MVA generation unit constructed by Ergon Energy for network support purposes in the Mount Isa region.