

Final Decision

Energex application for waiver from Queensland Ring Fencing Guidelines

March 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-2) |

# Summary

The current waiver application was submitted by Energex on 16 December 2015 for its Battery Energy Storage System (BESS) domestic[[2]](#footnote-3) pilot project incorporating solar photovoltaic (PV) generation and batteries.[[3]](#footnote-4) 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.

Energex described its BESS domestic pilot project as including batteries from three separate manufacturers, each with between 10 and 12 kW of storage capacity. The trial is to be undertaken at Energex's training facility in the Brisbane suburb of Rocklea. Energex indicated electricity exports to the grid from its facility would be minimal as most electricity generated by the project's PV units would be used on site.

Our view is that the BESS domestic pilot project 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 pilot project 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 distribution network service providers (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.[[4]](#footnote-5) We have received a number of submissions in response to Energex's waiver application and our draft decision. Submissions have, understandably, raised those broader scope issues in respect of Energex's current waiver application.[[5]](#footnote-6)

Most submissions opposed granting Energex a waiver because, they argued, DNSPs should not provide energy storage services. Rather, such services should be purchased from third party providers.[[6]](#footnote-7)

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 Energex'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.

Energex submitted that it will not sell electricity injected by its BESS domestic pilot project into the network so will not receive an immediate financial benefit. Energex's waiver application is premised on the pilot 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 to be established by the pilot project. Therefore we consider it appropriate for Energex to submit a ring fencing waiver application for our assessment.

Having considered materials submitted by Energex, submissions provided in response to its ring fencing application and the submission provided in response to our draft decision, our final decision is to grant a temporary waiver from section 1(b) of the Guidelines. The waiver is limited to the BESS domestic pilot project 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, including the existing Queensland Guidelines. In respect of this BESS domestic pilot 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 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.[[7]](#footnote-8) 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 22 December 2015 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 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.

## **BESS domestic pilot project**

Energex’s waiver application described Energex needing to develop a better understanding of how batteries used in conjunction with PV will impact its future network load profile and power quality. Energex also indicated that, while the pilot project is primarily to understand network operational issues, it may also provide insight for future capital investment and tariff reform decisions.[[8]](#footnote-9)

Energex submitted that the BESS domestic pilot project will simulate operation of batteries in conjunction with PV in a domestic (residential) scenario and will begin operations in early 2016. The domestic BESS pilot project will include three separate installations of batteries from Tesla (total storage 11.65kW), SunVerge (11.65kW) and Redflow (10kW). The SunVerge battery will be paired with a 3kW solar PV unit. The Tesla and Redflow batteries will be paired with 6kW PV units.

The BESS domestic pilot project will last three years. Over that time Energex expects generation from the pilot project will exceed the on­–site demand around one quarter of the time. That is, for three quarters of the project period all electricity generated by the project will be used on–site. Electricity generated by the project not used on–site will be exported to the network but will not be sold. This electricity sent into the network will be counted as a reduction in line losses — Energex will not receive a financial benefit.

Energex's waiver application describes two further pilot projects, one for small scale commercial premises and one for large scale commercial premises. These further projects are not the subject of Energex's current waiver application which is limited to the BESS domestic pilot project, as described above.

## A related business

Energex submitted:[[9]](#footnote-10)

While the BESS pilot projects involve 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 the pilot projects and expects the vast majority of the electricity to be used onsite.

## Costs of compliance with ring fencing obligations

For a ring-fencing waiver to be granted Energex must demonstrate the administrative cost of complying with the ring-fencing obligation outweighs the benefit, or any likely benefit, to the public. Energex did not initially submit its expected costs of ring fencing the BESS domestic pilot project with its waiver application. On 20 January 2016 we received a further submission from Energex setting out such estimates.[[10]](#footnote-11) 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 would ultimately be borne by Energex's customers through increases in network charges. Against these costs we must assess the potential benefit of requiring Energex to establish a separate legal entity to undertake the BESS domestic pilot project. Our assessment of these costs and benefits must be in light of the Guideline's focus on a related business of producing electricity.

We have taken Energex's proposed costs into account in considering Energex's waiver application.

## Reasons for seeking a waiver

Energex submitted:[[11]](#footnote-12)

Energex considers the administrative costs of complying with section 1(b) outweighs the benefit or likely benefit to the public given that the pilot projects facilitate integration of new technology, which some customers will wish to adopt, with the existing network assets.

Energex does not consider that the establishment and operation of this pilot project:

has any impact on the national electricity market given the negligible capacity of the pilot projects;

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 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 one submission on our draft decision on Energex's waiver application, from Origin Energy, which is available to view on the AER website.

Origin Energy opposed granting Energex a waiver. It submitted:[[12]](#footnote-13)

…the objectives of the QCA’s Ring-fencing Guidelines are to create an environment where competitive and potentially competitive markets are not compromised by the participation of a regulated distribution network.

The market for storage solutions is immature but is emerging. The AER has the ability to send a strong signal that it will foster a level playing field that will allow the market to mature and grow and provide confidence to new entrants that they will be able to compete on a fair and equal basis.

We maintain our view that there has been insufficient consideration of the potential detriments to competition by allowing Energex to operate in behind the meter activities and we encourage the AER to reconsider its decision to accept Energex’s application for waiver.

We have taken Origin Energy's submission into account in forming our view on Energex's waiver application.

We have also taken into account submissions provided previously in response to Energex's ring fencing waiver application.

## Our considerations

We accept that Energex's domestic BESS pilot project is to be undertaken for research purposes. Further, that the principal goal of the pilot project is to understand the implications for Energex's network of a broad consumer uptake of battery technologies. Energex 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 Energex would incur administrative costs in complying with the ring fencing requirements. Therefore, we consider the possible benefits from enforcing ring fencing requirements on Energex 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.

The pilot project will not be undertaken for business purposes, in that Energex will not sell electricity injected into the network. 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 pilot project.

While we note Origin Energy's comments regarding the emerging market for energy solutions, we do not consider that Origin Energy'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.

We consider that the Queensland Guidelines do not contemplate competitive neutrality and broader market contestability issues such as raised by Origin Energy and other, previously provided, submissions. As explained by the QCA in its final decision on the existing Guidelines:[[13]](#footnote-14)

…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 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.

We further note that new national ring fencing guidelines are unlikely to be as narrowly focussed as the current Queensland Guidelines. However, we must consider Energex's waiver application on the basis of the existing Queensland regulatory arrangements as established by the 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).[[14]](#footnote-15) For network storage the AEMC recommended we consider a range of factors when determining appropriate ring-fencing to apply in different circumstances.[[15]](#footnote-16) 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 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 BESS domestic pilot project. The temporary waiver relates only to the BESS domestic pilot project, not to the further commercial BESS projects described by Energex in its waiver application.

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-2)
2. Energex plans to undertake separate BESS trials for commercial sized customers. [↑](#footnote-ref-3)
3. Energex, Energex application for a ring­­-fencing waiver under the electricity distribution ring-fencing guidelines, December 2015. [↑](#footnote-ref-4)
4. AEMC, Final report — Integration of Storage: Regulatory Implications, December 2015. [↑](#footnote-ref-5)
5. 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-6)
6. Origin Energy, Re AER draft decision on Energex application for a ring–fencing waiver, February 2016. [↑](#footnote-ref-7)
7. Queensland Competition Authority, Final Determination: Electricity Distribution: Ring-Fencing Guidelines, September 2000, p.8. [↑](#footnote-ref-8)
8. Energex, Energex application for a ring­­-fencing waiver under the electricity distribution ring-fencing guidelines, December 2015, p.1.. [↑](#footnote-ref-9)
9. Energex, Energex application for a ring­­-fencing waiver under the electricity distribution ring-fencing guidelines, December 2015, p.2. [↑](#footnote-ref-10)
10. Energex, Energex application for a ring fencing waiver under the electricity distribution ring fencing guidelines, January 2016. [↑](#footnote-ref-11)
11. Energex, Energex application for a ring­­-fencing waiver under the electricity distribution ring-fencing guidelines, December 2015, pp.2–3. [↑](#footnote-ref-12)
12. Origin Energy, Re AER draft decision on Energex application for a ring–fencing waiver, February 2016, p. 2. [↑](#footnote-ref-13)
13. QCA, Final determination—Electricity distribution: ring–fencing guidelines, September 2000, p. 2. [↑](#footnote-ref-14)
14. AEMC, Final report — Integration of Storage: Regulatory Implications, December 2015. [↑](#footnote-ref-15)
15. AEMC, Final report — Integration of Storage: Regulatory Implications, December 2015, p. iv. [↑](#footnote-ref-16)