

Draft Decision

Energex application for waiver from Queensland Ring Fencing Guidelines

January 2016

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Contents

[Shortened forms 1](#_Toc436830187)

[Request for submissions 2](#_Toc436830188)

[1 Summary 3](#_Toc436830189)

[2 Queensland ring fencing guidelines 4](#_Toc436830190)

[2.1 Procedure for waiving ring fencing obligations 4](#_Toc436830191)

[3 Ergon Energy’s waiver application 5](#_Toc436830192)

[3.1 GUSS units 5](#_Toc436830193)

[3.2 A related business 5](#_Toc436830194)

[3.3 Costs of compliance with ring fencing obligations 6](#_Toc436830195)

[3.4 Reasons for seeking a waiver 6](#_Toc436830196)

[4 Our assessment 7](#_Toc436830197)

[4.1 Submissions 7](#_Toc436830198)

[4.2 Our considerations 7](#_Toc436830199)

[4.3 Our draft decision 8](#_Toc436830200)

# 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) |

# Request for submissions

This document sets out the Australian Energy Regulator’s (AER) draft decision on an application from Energex Limited (Energex) for a waiver from the Queensland Electricity Distribution Ring–Fencing Guidelines (the Guidelines).[[2]](#footnote-3)

Energex’s waiver application relates to a requirement under section 1(b) of the Guidelines specifying Energex may not carry on a business related to its role as an electricity Distribution Network Service Provider (DNSP).

Copies of Energex’s waiver application are available on the AER’s website [www.aer.gov.au](https://www.aer.gov.au/).

We invite submissions from interested parties on Energex's waiver application and this draft decision.

Submissions should be emailed to AERInquiry@aer.gov.au before 5pm on Monday 19 February 2016. Enquiries may be emailed to the same AER email address. Submissions may also be mailed to:

Mr Chris Pattas,

General Manager Network Investment and Pricing

Australian Energy Regulator

GPO Box 520

Melbourne Vic 3001

We prefer 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.

# Summary

On 16 December 2015 Energex submitted an application for a waiver from its ring fencing obligations in respect of its Battery Energy Storage System (BESS) domestic[[3]](#footnote-4) pilot project incorporating solar photovoltaic (PV) generation and batteries.[[4]](#footnote-5) Section 1(b) of the Guidelines prevents a distribution network service provider (DNSP), such as Energex, 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.

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.

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 the material submitted by Energex and taken into account submissions provided in response to its ring fencing application, our draft decision is to grant a temporary and conditional 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. 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 Queensland Competition Authority (QCA) published its Ring-fencing Guidelines in September 2000. The objective 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.[[5]](#footnote-6) The 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 could outweigh the likely benefit to the public.

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 (Queensland) Guidelines to date.

## 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:

“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 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 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 Guidelines as a business of producing, purchasing or selling electricity.

Section 21 allows the AER to waive the Guidelines' obligations if we consider the administrative costs of compliance will outweigh the public benefit. Section 22 of the Guidelines allows DNSPs to seek a notice from the AER to be issued under section 21.

## ****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.[[6]](#footnote-7)

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:[[7]](#footnote-8)

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 that 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. However, on 20 January 2016 we received a further submission from Energex setting out such estimates.[[8]](#footnote-9) 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.

## Reasons for seeking a waiver

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

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 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 five submissions on Energex's waiver application.[[10]](#footnote-11) The submissions did not support granting a waiver, mostly due to competitive neutrality considerations. For example, AGL submitted:[[11]](#footnote-12)

The BESS waiver application directly contemplates Energex operating behind-the-meter in the installation of a solar PV plus battery system. These are new markets in which competition has already emerged and continues to strengthen. It is of fundamental importance that participation by network businesses in contestable markets only occur through a legally, financially and operationally (including data and information) separate business and that the effectiveness of ring-fencing arrangements are subjected to regular independent audit. Otherwise these businesses will obtain an unfair advantage and distort competitive outcomes.

Energy Consumers Australia submitted:[[12]](#footnote-13)

ECA submits that the long term interest of consumers is best served by the strict separation of natural monopoly network businesses from all contestable services and that ring-fencing is also not an adequate remedy.

The Competitive Energy Association submitted:

Distribution businesses are funded by regulated revenue and so have a natural competitive advantage if they are permitted to apply that revenue to a competitive market activity or service. The concept of competitive neutrality demands that these parties separate what are considered contestable, market services from those that are rendered in monopoly markets. This application therefore raises some threshold issues regarding regulated network businesses moving into contestable services markets.

Energy Consumers Australia also objected to Energex's waiver application because supply of energy may be undertaken as a business without an intention to make a profit.[[13]](#footnote-14)

AGL and the Competitive Energy Association raised the possibility that Energex may develop intellectual property from the BESS domestic pilot project which could advantage it in a competitive market for provision of battery storage services.[[14]](#footnote-15)

Another issue raised in some submissions related to the content of Energex's waiver application. For example, Origin Energy submitted:[[15]](#footnote-16)

Energex has not provided an assessment of public benefits, detriments to competition, or submitted administrative costs associated with complying with section 1(b) of the Ring-fencing Guidelines. As a result there is no basis for the AER to assess this application. For these reasons, we believe that Energex’s application for waiver does not meet the waiver application requirements set out in the Ring-fencing Guidelines and therefore cannot be approved in its current form.

As noted above in section 3.3, Energex has now submitted an estimate of its costs should it be required to ring fence the BESS domestic pilot project.

We have taken submissions into account in forming our view on Energex's 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.

We note also that there is a materiality consideration in respect of the BESS domestic trial project. With only three residential size batteries it is a small research project. Any electricity exported to Energex's broader network will be minor in comparison to local consumption levels and insignificant at a network level.

The pilot project will not be undertaken for business purposes, in that Energex will not sell any 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.

Energex has proposed to fund the BESS domestic pilot project from its DMIA resources. We do not see anything to prevent this. Energex will be required to submit to us a DMIA report summarising outcomes from the pilot project. We encourage Energex to share further details with the broader energy sector through industry conferences and the like. The pilot project's results should provide insight to stakeholders of the impact batteries can have on networks, including how networks and domestic batteries will interact.

We note the views put forward in submissions regarding competitive neutrality. However, we must consider Energex's waiver application on the basis of the existing Queensland regulatory arrangements as established by the Guidelines.

We recognise that the potential provision of services from batteries will be subject to further policy direction from the Council of Australian Governments (COAG), the COAG Energy Council and the Australian Energy Market Commission (AEMC). This will factor in our development of new national ring fencing guidelines. At this point, we hold the view that contestable services should be provided in competitive markets. Networks should not be able to leverage off their monopoly business activities to gain an advantage in competitive markets. Many of the submissions we have received focused on these principles. These issues will be a focus of our consultation in developing new national guidelines.

As required by the current Guidelines, for Energex's waiver application we have considered the likely benefit to the public of enforcing the current ring fencing provisions against Energex's submitted cost estimates. To the extent that Energex's BESS domestic pilot project could be considered to be a related business as defined by the Guidelines, we consider there are unlikely to be material benefits to consumers from requiring Energex to undertake ring fencing in this instance. So even though the administrative costs of Energex ring fencing the project would be relatively minor compared to Energex's total revenues, they outweigh any potential benefit.

## Our draft 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. Queensland Competition Authority, Electricity Distribution Ring–Fencing Guidelines, September 2000. [↑](#footnote-ref-3)
3. Energex plans to undertake separate BESS trials for commercial sized customers. [↑](#footnote-ref-4)
4. Energex, Energex application for a ring­­-fencing waiver under the electricity distribution ring-fencing guidelines, December 2015. [↑](#footnote-ref-5)
5. Queensland Competition Authority, Final Determination: Electricity Distribution: Ring-Fencing Guidelines, September 2000, p.8. [↑](#footnote-ref-6)
6. Energex, Energex application for a ring­­-fencing waiver under the electricity distribution ring-fencing guidelines, December 2015, p.1.. [↑](#footnote-ref-7)
7. Energex, Energex application for a ring­­-fencing waiver under the electricity distribution ring-fencing guidelines, December 2015, p.2. [↑](#footnote-ref-8)
8. Energex, Energex application for a ring fencing waiver under the electricity distribution ring fencing guidelines, January 2016. [↑](#footnote-ref-9)
9. Energex, Energex application for a ring­­-fencing waiver under the electricity distribution ring-fencing guidelines, December 2015, pp.2–3. [↑](#footnote-ref-10)
10. Submissions are available to view on the [AER website](https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/ring-fencing-waivers) (www.aer.gov.au). [↑](#footnote-ref-11)
11. AGL, Re Energex ring fencing waiver application – Battery Energy Storage System trial, January 2016, p. 2. [↑](#footnote-ref-12)
12. Energy Consumers Australia, Energex Application for Ring Fencing Waiver, January 2016, p. 1. [↑](#footnote-ref-13)
13. Energy Consumers Australia, Energex Application for Ring Fencing Waiver, January 2016, p. 1. [↑](#footnote-ref-14)
14. AGL, Re Energex ring fencing waiver application – Battery Energy Storage System trial, January 2016, p. 2; Competitive Energy Association, Energex Application for a Ring-fencing waiver under the Electricity Distribution Ring-Fencing Guidelines, January 2016, p. 2. [↑](#footnote-ref-15)
15. Origin Energy, Re. Submission to Energex application for a ring fencing waiver, January 2016, p. 3. [↑](#footnote-ref-16)