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Chris Pattas
General Manager – Network Operations and Development
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Dear Mr Pattas

ERGON ENERGY CORPORATION LIMITED APPLICATION FOR A RING-FENCING WAIVER UNDER SECTION 21 OF THE ELECTRICITY DISTRIBUTION: RING-FENCING GUIDELINES

Ergon Energy Corporation Limited (Ergon Energy) is writing to the Australian Energy Regulator (AER) to formally seek a waiver from Section 1(b) of the AER's Final Determination Electricity Distribution Ring-Fencing Guidelines, September 2000[1] (the Ring-Fencing Guidelines). Section 1(b) of the Ring-Fencing Guidelines provides:

> *that a distribution network service provider that provides prescribed distribution services in Queensland must not carry on a related business within that legal entity.*

The term "related business" is defined in the Ring-Fencing Guidelines to mean the business of producing, purchasing or selling electricity.

Specifically, this waiver application relates to the ownership and operation of a 1.0MVA[2] network support grid-connected generation option constructed by Ergon Energy in the Mount Isa region, to alleviate identified feeder constraints. Appendix 1 (confidential) shows the location of the proposed generator.

Background to Application

All 11kV loads in the town of Mount Isa are supplied by a single 132/66/11 kV zone substation. In May 2011, it was identified via network demand management investigations that the substation load was growing by approximately 4.3% p.a. and was forecast to exceed its N-1 rating of 47.6MVA in summer 2015/16. Furthermore, most of

[1] http://www.aer.gov.au/node/12976, Queensland Ring-Fencing Guidelines (September 2000)

[2] The nameplate rating of the Mount Isa generator is 1250 kVA and will have 1250 kVA output

the ten 11 kV feeders that zone substation supplies were identified as being 3 into 2 constrained[3] at that stage and the peak load in summer 2009/10 exceeded the thermal ratings on three of these feeders.

In February 2012 a customer demand management and embedded generation proposal was compiled outlining a potential 2.0 MVA in Demand Management combined with 1.6MVA in third party contracted embedded generation to assist in reducing the feeder load issues identified at Mount Isa. At this time, two 11 kV feeders were identified as the highest priority feeders taking into account actual or forecasted loads. A business case for the implementation of the proposal was approved in mid-2012.

A total targeted 1.6MVA of embedded generation capacity was planned to come from three sites - one of size 1.0MVA, and two sites of size 0.3MVA. Ergon Energy's commercial, industrial and corporate work group have since managed the process of contracting for connection of the potential embedded generation sites to alleviate summer loads in Mount Isa. A first site (0.3MVA) has been connected and is available for network support from summer 2012/13 and ready for dispatch (though not used to date). The intention was for the remaining two sites (0.3MVA and 1.0MVA) to be contracted and available for network support for the 2013/14 and future summer peaks.

In this regard, a second 0.3MVA site is well advanced (planned for connection and commissioning towards end-December 2013). However, after considerable negotiation and consultation, a final commitment was not able to be reached by the required date of 9 July 2013 for a final 1.0MVA site.

As a result, a contingency/emergency plan was quickly instigated by Ergon Energy to provide the necessary 1.0MVA of network support for the distribution network to avoid potential load shedding due to exceeding thermal ratings in the forthcoming summer.

In August 2013 a decision was made for Ergon Energy to design and install a network embedded generation (NEG) option that would inject directly in the high voltage network on one of the two high priority feeders identified. This was required to be done as a matter of urgency due to the time frame regarding potential impending summer load and the fact that last year the load exceeded the thermal capacity of the feeder. It is intended the generator be dispatched only at times of absolute necessity to prevent customer load shedding. The NEG solution was able to be rolled out in a short timeframe (to mitigate the summer load risk), and is intended to be established and available for dispatch for network support from 1 November 2013 to 1 April 2014. Thereafter, the NEG would need to be established each year for the summer load until summer 2016/17. At this stage the connection will be re-assessed.

A planned connection date is set for mid-December 2013. Metering design is complete and compliant metering will be installed prior to connection. Operation for network support purposes will not occur until appropriate operation and dispatch protocols are in place. Ergon Energy will advise the AER of the expected date for operation in due course.

Notification was provided to the AER of the readiness of the generator to become connected and operational, on 18 October 2013. However, Ergon Energy notes this has not allowed for the appropriate time frames for consultation/submission of a Ring-Fencing waiver from section 1(b) of the Ring-Fencing Guidelines which prohibits carrying on a 'related business' by Ergon Energy including the carrying on of a business of producing, purchasing or selling electricity. However, we request that consideration be given to the emergency contingency requirements for network support over the impending summer of

[3] Ergon Energy criteria when the investigation was undertaken was to keep within '3 into 2 constraint' – if you lose one feeder out of three the other two feeders should be able to take up the load

2013/14, following the last minute breakdown of negotiations for an alternative contracted arrangement for supply of 1.0MVA generation.

Issues

Obligation 1(b) of the Ring-Fencing Guidelines provides that a distribution network service provider (DNSP) that provides prescribed distribution services in Queensland must not carry on a related business[4] within that legal entity. Ergon Energy recognises that the installation of the network support grid-connected generation at Mount Isa, is for the production of electricity. Strictly read, obligation 1(b) prevents Ergon Energy from owning generation assets unless a waiver is granted from the AER from complying with this obligation of the Ring-Fencing Guidelines.

Waiver Requirements

Section 22 of the Ring-Fencing Guidelines states that a DNSP may apply to the AER requesting the AER to issue a notice under section 21. This provides that the AER may by notice to a DNSP, waiver any of a DNSP's obligations under section 1, provided that the AER 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.

Whilst Section 21 of the Ring-Fencing Guidelines sets out the criteria to be used in determining whether a waiver should be granted, Ergon Energy submits that this criteria should be considered in conjunction with an examination of the historical treatment of such assets, other statutory instruments (Appendix 1) and the commercial and political environment which impact Ergon Energy's generation activities, and the emergency contingency requirements for network support facing Ergon Energy in the Mount Isa region with the impending summer period.

Reasons for Seeking a Waiver

- Under section 42(b) of the Electricity Act 1994 (Qld) (Electricity Act), Ergon Energy must operate, maintain (including repair and replace as necessary) and protect its supply network to ensure the adequate, economic, reliable and safe connection and supply of electricity to its customers.

- Ergon Energy is continually looking at ways to meet these requirements and improve the reliability and performance of its network. In certain situations the most technically and economically efficient response is to have generation available to supply customers – as opposed to augmenting existing networks, or duplicating networks.

- The network support grid-connected generation option is to be operated and maintained consistently with Ergon Energy's other assets providing distribution services.

- Section 42(d) of the Electricity Act imposes as a condition of Ergon Energy's Distribution Authority that it consider both demand side and supply side options to provide, as far as technically and economically practicable, for the efficient supply of electrical energy.

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[4] related business means the business of producing, purchasing or selling electricity

- Ergon Energy's Distribution Authority and the "conditions of a distribution authority" contained in the Electricity Act and *Electricity Regulation 2006* (Qld) (Electricity Regulation) (including section 129) give special approval to Ergon Energy for use of generation in order to fulfil Ergon Energy's obligations to allow access and supply energy.

- Ergon Energy's Company Constitution states that one of the objects of the company is to carry out generation activities, but only in five defined circumstances, which are primarily to enable Ergon Energy's obligations under the Electricity Act and Electricity Regulation to be met.

- Ergon Energy's Network Support Grid-Connected generation option will:
  - not have a National Electricity Market impact;
  - not result in Ergon Energy entering the generation or retail markets;
  - not be of significant capacity such that it could be construed to be re-integrating the electricity industry functions

  but rather are to satisfy Ergon Energy's obligations under the Electricity Act and Electricity Regulation with regard to network matters.

- In order to establish a separate Ergon Energy subsidiary company to own and operate a small number of small generation assets is a lengthy process, and is the responsibility of Commercial Monitoring within Queensland Treasury and Trade, which is hesitant about establishing new Government Owned Corporation (GOC) companies or subsidiary companies, unless they can assess that there is both an absolute necessity at law and a net public benefit to be derived.

- The *Government Owned Corporations Act 1993* sets out the mechanism for creating GOCs. An approval for the establishment of a GOC Subsidiary Company is ultimately at the discretion of the Shareholding Ministers.

- From historical experience, Ergon Energy estimates the costs of establishment of a new GOC subsidiary company to house the generation assets and minimum associated budgeted annual operating costs to be $13,000 and $174,500 respectively (Appendix 2). As the generating unit is providing Standard Control Services and is considered to form part of Ergon Energy's regulatory asset base, the additional costs involved with the establishment and operation of a new subsidiary would need to be passed on to customers.

- Ergon Energy considers that even if network support generating units were housed in a separate company – since they are delivering Standard Control Services, there would be repetition of asset register, financial controls, auditing and economic regulation – thus delivering no additional public benefit – but rather, would attract significant increased costs (being at least the $174,500 annual costs mentioned above) to fund the quarantined treatment of the assets.

- Housing generation assets in a separate legal entity will not deliver any significant improvement to the benefit over and above what is currently occurring.

In applying these principles, Ergon Energy notes that in June 2010 the Queensland Competition Authority granted a waiver application with respect to Ergon Energy's network support generator in the Barcaldine region.

Ergon Energy submits that this waiver application is reasonable on the grounds that the extra costs, bureaucracy and complexity to remove Network Support Grid-Connected Generation into a separate legal entity are not commensurate with the benefits to be derived (if any) to the public. Further, the use of these assets by a DNSP complies with the provisions and intent of Queensland legislation.

Should you require further information, please contact Kim Casey, Manager Regulatory Affairs – Performance and Reporting on 0428 197 012.

Yours faithfully

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