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23 December 2019

Ms Michelle Groves  
Chief Executive Officer  
Australian Energy Regulator  
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Melbourne VIC 3001

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Dear Ms Groves

### **Ergon Energy's waiver application under the Australian Energy Regulator's Ring-fencing Guidelines**

Ergon Energy Corporation Limited (Ergon Energy) is part of the Energy Queensland Group and manages an electricity distribution network which supplies electricity to more than 740,000 customers. Our vast operating area covers over one million square kilometres – around 97% of the state of Queensland – from the expanding coastal and rural population centres to the remote communities of outback Queensland and the Torres Strait. Our electricity network consists of approximately 160,000 kilometres of powerlines and one million power poles, along with associated infrastructure such as major substations and power transformers. We also own and operate 33 stand-alone power stations that provide supply to isolated communities across Queensland which are not connected to the main electricity grid.

Under the *National Electricity Rules* Ergon Energy must comply with the Australian Energy Regulator's (AER) Electricity Distribution Ring-fencing Guideline (the Guideline).<sup>1</sup> However the Guideline permits Ergon Energy to apply for a waiver of the legal separation and the functional separation obligations and on this basis, Ergon Energy is seeking a waiver of:

- the legal separation obligation under clause 3.1(b) of the Guideline which provides that a DNSP may provide distribution services and transmission services but must not provide 'other services'.
- the functional separation obligations under clause 4.2 of the Guideline which provide that a DNSP may not co-locate regulated and unregulated services, share staff between regulated and unregulated services and use the same branding for both regulated and unregulated services.

Ergon Energy is committed to providing Queensland customers with services that are affordable, sustainable and safe. The intent behind this waiver application is to deliver on this

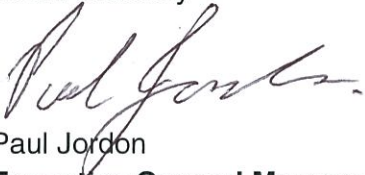
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<sup>1</sup> Clause 6.17.2.

commitment. Ergon Energy has highly skilled staff performing works on their own assets in the same areas as Powerlink, and as such, we consider that allowing Ergon Energy to provide prescribed and negotiated transmission services on behalf of Powerlink will create scale efficiencies at a regional level. By granting a waiver, Ergon Energy will be able to deliver consolidated services and therefore facilitate the achievement of the National Electricity Objective.

Ergon Energy appreciates the AER's ongoing support and looks forward to providing continued assistance in considering our attached waiver application. Should you require additional information or wish to discuss any aspect of this application, please do not hesitate to contact me or Alena Christmas, Senior Policy and Regulatory Reform Analyst, Regulation and Pricing, on (07) 3851 6784.

Yours sincerely



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*Encl: Ergon Energy's ring-fencing waiver application*

# Ergon Energy's Ring-fencing Waiver Application



23 December 2019



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# 1.Introduction

Ergon Energy Corporation Limited (Ergon Energy) forms part of the Energy Queensland Group and is a Queensland Government Owned Corporation. Ergon Energy builds, operates and maintains an electricity distribution network and supplies electricity to more than 750,000 customers over a vast operating area covering one million square kilometres – around 97 per cent of the state of Queensland. Ergon Energy’s supply area covers the expanding coastal and rural population centres to the remote communities of outback Queensland and the Torres Strait. There are over 150,000 kilometres of power lines and approximately one million power poles in the Ergon Energy distribution network, along with associated infrastructure such as major substations and power transformers.

Queensland’s Electricity Transmission Corporation Limited (Powerlink) is seeking Ergon Energy, to provide support services, to operate, maintain, construct and refurbish Powerlink owned or controlled transmission assets within Queensland. The activities related to the support services detailed in Section 2.3, relate to the provision of Powerlink’s prescribed and negotiated transmission services only.

Powerlink has had an enduring service provision relationship with Ergon Energy for the provision of these services over time, with the first Service Level Agreement (SLA) between the parties commencing in the late 1990s. The intent of this arrangement has always been for Ergon Energy’s resources and expertise in the delivery of network services to act as an industry extension of Powerlink’s own resource and service capability, by leveraging similar safety and specialised technical capabilities.

The National Electricity Rules (NER) requires Ergon Energy to comply with the Australian Energy Regulator’s (AER’s) *Ring-fencing Guideline Electricity Distribution* (the Guideline)<sup>1</sup>. Ergon Energy is committed to compliance with the Guideline but is supportive of the grant of waivers by the AER where appropriate with a view to the better achievement of the National Electricity Objective (NEO) and net benefits in terms of the long-term interests of consumers.

The most recent SLA was entered into between Ergon Energy and Powerlink in March 2015, prior to the current suite of ring-fencing obligations requiring legal and functional separation commencing. Ergon Energy, in its commitment to comply with the spirit of the Guideline, novated the existing SLA to its affiliated entity Yurika in 2018. Ergon Energy is now seeking to enter into a new SLA (on terms to be negotiated) between Powerlink and Ergon Energy that will cover the waiver period.

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<sup>1</sup> Version 2, which was published in October 2017.

## 2. Description of waiver being sought

### 2.1 Obligation subject of the waiver

Ergon Energy is seeking a waiver of the legal separation obligation under clause 3.1(b)<sup>2</sup> and functional separation obligations under clause 4.2<sup>3</sup> of the Guidelines, in order to provide a suite of support services under an SLA to Powerlink in respect to transmission assets which they own or that are under their control. The waiver is limited to the provision of Powerlink's prescribed and negotiated transmission services only.

This request is consistent with the acknowledgement from the AER that a waiver for functional separation is often appropriate when a waiver for legal separation has been granted<sup>4</sup>:

### 2.2 Reasons for seeking a waiver

Powerlink is a Queensland Government Owned Corporation that owns, develops, operates and maintains the high-voltage electricity transmission network in Queensland. The network extends 1,700 kilometres from the north of Cairns to the New South Wales border covering significant areas of regional Queensland.

Powerlink has an obligation to provide transmission services and is seeking Ergon Energy, to assist it in providing these services on its behalf in relation to activities on Powerlink owned or controlled assets and relate to the provision of Powerlink's prescribed and negotiated transmission services only. When provided by Ergon Energy, the services are classified as 'other services' for the purposes of the Guideline's application to Ergon Energy.

Regulated network service providers can and do actively source third parties to provide a range of services through competitive procurement processes. Powerlink, in its discussions with Ergon Energy, has determined that because Ergon Energy works in the same geographic areas as Powerlink's assets and that Ergon Energy has the requisite knowledge and skills to undertake these activities, Powerlink can leverage and create efficiencies by accessing Ergon Energy's established footprint and skilled resources in regional Queensland. This will provide efficiencies in the delivery of the services and therefore benefit all customers in regional Queensland.

Utilising Ergon Energy's existing specialist staff and equipment and regional footprint allows for a safe and more timely response where network and/or safety issues occur, either on the transmission or distribution network, the impacts on the other network and network assets can be dealt with quickly, appropriately and efficiently.

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<sup>2</sup> the legal separation obligation required under clause 3.1(b) of the Guideline provides that a DNSP may provide distribution services and transmission services but must not provide 'other services'.

<sup>3</sup> the functional separation obligations required under clause 4.2 of the Guideline provide that a DNSP may not co-locate regulated and unregulated services, share staff between regulated and unregulated services and use the same branding for both regulated and unregulated services.

<sup>4</sup> AER, *Electricity distribution Ring-fencing Guideline Explanatory statement*, November 2016, p. 55.

These benefits are not limited to potential cost efficiencies but also to the positive impacts on the overall operation of electricity services.

### **2.3 Details of services for which the waiver is being sought**

As previously stated, the support services subject to the waiver application are services including to operate, maintain, construct and refurbish Powerlink owned or controlled transmission assets in Queensland. A detailed list of activities is provided in the Appendix.

### **2.4 Proposed waiver commencement date and expiry date**

Ergon Energy proposes that the waiver commences immediately upon being granted and expires on 30 June 2025. The proposed expiration date of 30 June 2025 aligns with the end of the next regulatory control period.

### **2.5 Details of the costs associated with Ergon Energy complying with the obligation if the waiver is refused**

If the waiver is refused, there are opportunities that cannot be realised as a result of the inability to leverage efficiency savings of Ergon Energy performing the support services, including resource management, works scheduling and related corporate and support services.

In addition, there are likely to be higher costs to Powerlink (and therefore all network customers) if Powerlink is required to develop state-wide internal capability or procure these support services from multiple providers across the relevant markets. Specifically, this would require the administration and management of multiple services agreements and would not enable savings as a consequence of economies of scale inherent in single partner arrangements, such as that historically offered by Ergon Energy. In addition, transmission users could face higher costs and potentially lower levels of service (e.g. slower field response times) through Powerlink's inability to procure the skills, expertise and established footprint in regional Queensland that Ergon Energy currently provides.

### **2.6 Regulatory control periods to which the waiver applies**

The waiver would apply in two regulatory control periods:

1. The remainder of Ergon Energy's current period: 2015 – 2020; and
2. Ergon Energy's subsequent regulatory period: 2020 – 2025.

## **2.7 The Additional measures to be undertaken on granting of a waiver**

The waiver is proposed for a limited period of time to ensure that any arrangement entered into between Ergon Energy and Powerlink will be re-examined to ensure that it remains commercially efficient, cost effective and in the long-term interests of consumers.

## **2.8 Reasons why Ergon Energy considers the waiver should be granted with reference to the matters specified in clause 5.3.2(a), including the benefits, or likely benefits, of the grant of the waiver to electricity consumers**

Clause 5.3.2(a) of the Guideline provides that the AER, in assessing a waiver application and deciding whether to grant a waiver or refuse to grant a waiver, must have regard to:

- The National Electricity Objective (NEO);

The National Electricity Law provides that:

The National Electricity Objective is to promote efficient investment in, and efficient operation and use of, electricity services for the long-term interests of consumers of electricity with respect to:

- price, quality, safety and reliability and security of supply of electricity
- the reliability, safety and security of the national electricity system.

Both elements of the NEO are of importance in considering this waiver application.

In examining the SLA and whether an application for a waiver is appropriate and aligned with the NEO, the impacts on consumers must be at the core of the decision-making process. Ergon Energy and Powerlink have made commitments to put consumers at the heart of how they operate their respective businesses. This is evidenced by their commitment to the Energy Charter (Charter). The Charter aims to progress the culture and solutions required to deliver a more affordable, sustainable and reliable energy system for all Australians.

The SLA was established to ensure that vital specialised support services would be provided to Powerlink by a service provider that can assist in delivering regulated transmission services, and Ergon Energy has these necessary resources, expertise and established footprint throughout regional and remote areas of Queensland to achieve this. In addition, there is significant benefit in having Ergon Energy undertake the work for Powerlink as it has a deep understanding of the network assets from a 'whole of network' perspective.

The waiver will allow Ergon Energy to provide Powerlink with the services is in the long-term interests of Queensland consumers. In particular, the services being provided to Powerlink are in regional and remote areas where transmission assets are located and there is limited competition. Further, establishing dedicated alternative resources would duplicate Ergon Energy's capacity and would be inefficient and therefore could have negative cost impacts for Queensland consumers. Ergon Energy, as result of working in the same geographic area, has invaluable local knowledge of the area including the terrain, operating environment and established relationships with landowners and other stakeholders. This knowledge and experience promotes the work being undertaken



efficiently and safely. Ergon Energy has highly skilled staff performing works on their own assets in the same areas and leveraging this to allow the same highly skilled staff to service Powerlink creates scale efficiencies and resulting cost reductions for both organisations.

- The potential for cross-subsidisation if the waiver is granted or refused;

As noted above, Powerlink has an enduring service provision relationship with Ergon Energy, with the intent of this arrangement being the creation of an industry extension of Powerlink's own specialised resource and technical service capability. Under a waiver, the AER would continue to have oversight through its consideration of Powerlink's transmission determination. Ergon Energy considers that this regulatory determination review mitigates any risks of cross-subsidisation.

Ergon Energy also submits that there would be no cross-subsidisation between its regulated services and non-regulated services as a result of a waiver to allow Ergon Energy to provide the support services to Powerlink. Ergon Energy maintains separate accounts for its regulated distribution services, unregulated distribution services and non-distribution services in accordance with the principles and policies of its Cost Allocation Methodology (CAM).

As a result of the principles of the CAM, the operation of the SLA may result in costs being shared between different classes of services but would prevent the same costs being attributed to more than one category. As a result, Ergon Energy would not cross-subsidise the provision of the support services to Powerlink but rather costs that were not previously attributable to more than one category may potentially be attributed to several categories.

This provides efficiencies to the customers of both Ergon Energy and Powerlink and is in their long-term interest.

- The potential for discrimination if the waiver is granted or refused

The Guideline impose obligations that aim to prevent discrimination. Ergon Energy submits that there is no discrimination in providing support services to Powerlink. Powerlink assessed the market and have indicated that it does not consider that there is a competitive supplier who can provide the services to the same service standard as Ergon Energy in as an efficient manner. Powerlink approached Ergon Energy as it could not source a service provider who has the ability to provide a holistic service with highly specialised, skilled staff and regional footprint to cover the desired locations. The SLA is a commercial transaction that is driven by Powerlink's desire to engage with an entity that can provide a comprehensive service and achieve economies of scale.

In terms of materiality, the arrangement currently in place involves Ergon Energy delivering approximately 50% of the total maintenance works undertaken by Powerlink for prescribed and negotiated transmission service purposes.

- Whether the benefit, or likely benefit, to electricity consumers of the DNSP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the DNSP of complying with that obligation.

The cost of compliance of the obligation is explicitly related to the costs relevant to Ergon Energy. Ergon Energy considers that the costs of complying with the relevant obligation will be borne by Powerlink (and therefore transmission customers) through increased costs if Powerlink is required

to source the services from multiple parties rather than a single entity, such as Ergon Energy. There is no benefit to electricity consumers if Ergon Energy is prevented from providing support services to Powerlink. However, there is benefit to Queensland consumers in Ergon Energy delivering the entire suite of services to support the provision of Powerlink's prescribed and negotiated transmission services as Powerlink's costs will be reduced by delivering through scale efficiencies and timely delivery of services and service quality. Our aim in entering into a new SLA is to ensure better outcomes for customers.

### **3. Conclusion**

Ergon Energy submits that its waiver application promotes the NEO, appropriately allocates costs between the regulated and unregulated services pursuant to the CAM and does not result in discrimination.

In granting the waiver from the legal and functional separation obligations of the Guideline, Ergon Energy considers that there will no harm to consumers, especially as it relates to the harms that the Guideline is trying to prevent. Both Ergon Energy and Powerlink have AER approved CAMs, which ensure that they have separate accounts and are able to report on transactions between itself and its affiliates. This ensures transparency over costs coming into Ergon Energy related to the provision of other services to Powerlink.

In relation to the second harm, discrimination, that the Guideline seeks to prevent, Ergon Energy considers there is no potential for discrimination if the waiver is granted as both entities have CAMs which cover cost allocations relevant for all regulated and unregulated services. Also, as Powerlink and Ergon Energy are not related affiliates, there is also no ability to discriminate between entities contrary to the intent of the Guideline.

The maintenance and operation of network assets is a specialised industry which requires highly skilled labour, and, in this case, Ergon Energy is best placed to provide the support services to Powerlink given its expertise and experience with network assets.

The SLA is a commercial arrangement that is negotiated between two parties to ensure commercial terms and efficient costs for the consumers of Queensland and does not require the additional costs associated with the additional oversight and programs to ensure another party can satisfy Powerlink that the required standard is being met.

Ergon Energy submits that a waiver to allow it to provide the support services to Powerlink under the SLA is in line with the long-term interests of consumers and puts them front and centre in the decisions the business makes. Furthermore, as regional Queensland covers a significant area of land, Ergon Energy is best placed to deploy assets into all these areas to undertake the work required on Powerlink's system. Therefore, the granting of waiver in this case meets the objective of the Guideline, promotes the NEO and is to the benefit of the consumers of Queensland.

## Appendix

### Detailed List of Services Subject to Waiver Application

Transmission maintenance works in Ergon Energy's distribution area, include the following:

- Field maintenance (emergency response, planned and unplanned), including transformer and high voltage test services and transmission line high voltage live work
- Metering diagnostic services (e.g., meter testing and accuracy calibration) under Powerlink's Accreditation and Registration
- Switching for high voltage isolation and access
- Substation and equipment safety testing services
- Plant management and defect reporting
- Forced outages and human error investigations
- Recommissioning or replacement of high voltage plant
- Regional representation for Powerlink:
  - Regional Officer accountable for all operations in a geographic area
  - Regional Contact Officer accountable for advice to third parties proposing to work near transmission assets
  - Office for Local Security accountable for the security of allocated transmission assets.

Project works in Ergon Energy's distribution area:

- Construction works for both transmission lines and substations
- Transformer and high voltage test services
- Factory acceptance testing of secondary systems
- Site acceptance testing of secondary systems
- Safety observers
- Site supervision and inspections.

Auxiliary services in Ergon Energy's distribution area:

- Property/easement inquiries
- Stores management and facility rental
- Outage coordination services.