

# Ring-Fencing Guideline – Electricity Distribution November 2016

## Waiver Applications by Essential Energy

This document contains five waivers submitted by Essential Energy to the AER on July 27, 2017 in relation to the Ring Fencing Guideline. These waivers are:

- **Essential Water** – Essential Energy (trading as Essential Water) is a water supply authority as prescribed by the *Water Management Act 2000* (NSW) with an area of operation in Far Western NSW centred around Broken Hill. Essential Water is regulated by IPART in NSW. This waiver requests the obligations for legal separation be waived for Essential Water;
- **Water Access Agreement with Clarence Valley Council** – Essential Energy has an agreement in place with the Clarence Valley Council to allow for a sharing of maintenance costs of water assets associated with the extraction of potable water for the Council utilising Essential Energy's Nymboida Hydroelectric Power Station and water extraction licence. This is a monopoly service. This waiver requests the obligations for legal separation be waived for the Water Access Agreement;
- **Residual Type 4 Contestable Meters** – Essential Energy is likely to retain ownership of a small number of contestable type 4 meters after the compliance due date in the Ring Fencing Guideline (around 100). Essential Energy is reliant on Retailer action for their transfer. A small number of meters are for active NMI's that have no active customer, and therefore no retailer to take ownership. This waiver requests the obligations for functional separation be temporarily waived to allow Retailers to take action to transfer these meters;
- **LED Streetlighting** – LED Streetlighting is being reclassified as an alternative control service from 1 July, 2019 as per the final 'Framework and approach' released by the AER on July 27. This waiver requests the obligations for functional separation to be waived until the 2019-2024 Framework and Approach comes into effect;
- **Nightvision** – Security lights is being reclassified as an alternative control service from 1 July, 2019 as per the final 'Framework and approach' released by the AER on July 27. This waiver requests the obligations for functional separation to be waived until the 2019-2024 Framework and Approach comes into effect.

July 2017



# Ring-Fencing Guideline – Electricity Distribution November 2016

## Waiver Application by Essential Energy: Essential Water

July 2017



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## 1. Introduction

This paper outlines Essential Energy's application for a waiver of clauses 3.1, 4.2 and 4.4.1(a) of the Ring Fencing Guideline – Electricity Distribution (Guideline) which prevents a Distribution Network Service Provider (DNSP) from providing services other than *distribution services* and *transmission services*.

Essential Energy applies for a waiver of the obligations contained in clauses 3.1, 4.2 and 4.4.1(a) of the Guideline to allow Essential Energy to continue to manage the Essential Water business without being required to separate the Essential Water business legally or functionally from the regulated Essential Energy business. Essential Energy submits that complying with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline, which would require the maintenance of two separate businesses and the physical separation of staff and offices of the two businesses, would result in increased costs for Essential Water and Essential Energy customers for no public benefit.

## 2. Description of service – Essential Water

Essential Energy (trading as Essential Water) is a water supply authority as prescribed by the *Water Management Act 2000* (NSW), and is obligated to exercise the functions conferred or imposed upon it under that Act. Essential Energy's area of operation as a water supply authority is: that land within the local government area of Broken Hill City Council; and the Stephens Creek, Uumberberka Creek and Yancowinna Creek Special Areas; the localities of Menindee and Sunset Strip; and the land over which the Menindee to Stephens Creek pipeline is situated.<sup>1</sup>

### 2.1 History of Essential Water

The NSW Government's Australian Inland Energy Water Infrastructure Act 2000 merged the Broken Hill Water Board and the far west NSW electricity distribution business Australian Inland Energy to form Australian Inland Energy and Water. The newly merged entity functions for water and sewerage came under the NSW Water Management Act 2000, and subsequent general and water supply authorities regulations.

A name change in 2003 to Australian Inland was followed by a merger with the NSW electricity distributor Country Energy in July 2005. This established a unique organisation providing water and sewerage services to the Broken Hill and surrounding region, under the umbrella of a State Owned Corporation electricity business. A further trading name change to Country Water, better reflecting the water business functions, occurred in March 2006.

With the separation of electricity retail functions from the electricity distribution business, Country Energy became Essential Energy in March 2011. Essential Water became the new trading name for the water and sewerage business based in Broken Hill.

Essential Energy's water-related functions include providing water, sewerage, liquid trade waste and miscellaneous services in the far west of NSW. Essential Water provides water supply services to over 10,000 customers in Broken Hill, Menindee, Sunset Strip and Silverton. In addition, sewerage services are provided to Broken Hill. The sections below provide an overview of these services.

### 2.2 Water supply services

Essential Energy supplies a total of approximately 6,500 ML of water per year to around 9,935 residential customers and 604 non-residential customers in the Broken Hill area. Essential Energy also provides non-potable water to 47 rural users along the Menindee to Broken Hill pipeline for stock and domestic purposes. The following provides a breakdown of Essential Energy's water supply services.

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<sup>1</sup> Regulation 108, *Water Management (General) Regulation 2011* NSW

### 2.2.1 Treated water

Treated water is known as potable water or drinking water. The water is disinfected and filtered to a standard that is fit for human consumption. Essential Energy supplies treated water to Broken Hill and Menindee.

### 2.2.2 Untreated water

Untreated water is also referred to as raw water. This is water in its natural state, prior to any treatment process, or the water entering the first treatment process of a water treatment plant. It is not suitable for human consumption. Essential Energy supplies untreated water to selected locations in Broken Hill and Menindee, and to customers along the Menindee and Umberumberka pipelines.

### 2.2.3 Chlorinated water

Chlorinated water is raw water that has been treated with a chlorine disinfection process but not filtered to remove solids and organic particles. This water is not suitable for human consumption. Essential Energy supplies chlorinated water to Silverton and Sunset Strip.

## 2.3 Effluent water

Effluent water is sewage or waste water that is treated at a sewerage treatment plant before being re-used or discharged to the environment. Effluent water is not suitable for human consumption and may only be re-used under specific environmental conditions. Essential Energy supplies effluent water to several customers for use in processing operations, dust suppression and irrigation.

### 2.3.1 Sewerage services

Essential Energy also provides sewerage services to approximately 9,500 properties in the city of Broken Hill, including some houses and other buildings in the Perilya mining lease area. Essential Energy operates two sewage treatment plants and around half of the treated effluent is sold for non-drinking purposes. The remaining half is discharged to the environment through evaporation ponds.

### 2.3.2 Trade waste and miscellaneous services

Essential Energy provides liquid trade waste services to non-residential customers in the city of Broken Hill only. Essential Energy provides a range of miscellaneous services to its water and sewerage customers. These are generally one-off services such as connections and disconnections, replacing damaged services, plumbing inspections, site inspections and building plan approvals. Charges for these miscellaneous services are levied on a relatively small number of customers, and are charged on an as needed basis.

## 3. Description of waiver being sought

### 3.1 Obligation subject of this waiver

As required by the National Electricity Rules (NER) under clause 6.17.2, the AER published the Ring-Fencing Guideline – Electricity Distribution in November 2016. Clause 6.17.1 of the NER requires *DNSP*'s to comply with the Guideline.

Clause 3.1(b) of the Guideline provides that 'a *DNSP* may provide *distribution services* and *transmission services*, but must not provide *other services*'. Clause 3.1(e) of the Guideline permits a *DNSP* to 'apply for a waiver of the obligations'.

Clauses 4.2 and 4.4.1(a) of the Guideline require *DNSP*'s to functionally separate the offices, staff and branding/cross-promotion of direct control services from contestable electricity services, and ensure any new or varied agreements with service providers include provisions requiring the service provider to comply with the Ring Fencing Guideline. Clauses 4.2.5 and 4.4.2 of the Guideline permit a *DNSP* to apply for a waiver of these obligations.

Essential Energy is seeking a waiver of clauses 3.1, 4.2 and 4.4.1(a) with regards to the services offered by Essential Water.

### 3.2 Proposed waiver commencement date and expiry date

Essential Energy requests that the waiver be granted from 1 December 2016 (the commencement date of the Guideline) with an expiry date of 30 June 2024 (the end of the next regulatory control period) as allowed for by clause 5.3.4(b). These dates have been selected to allow the waiver to be in operation for the longest duration possible given Essential Energy does not foresee any change in the Essential Water service during that timeframe.

### 3.3 Regulatory control periods to which the waiver applies

The requested waiver will cover the remainder of the 2015-2019 regulatory control period as well as the full 2020-2024 regulatory control period.

## 4. Legislative arrangements for waivers

Clause 5.2 states that 'a *DN*SP may apply in writing to the AER for a waiver of its obligations under clauses 3.1, 4.2 and/or 4.4.1(a) of this Guideline'. Furthermore, this clause states 'an application for waiver must contain all information and materials necessary to support the *DN*SP's application, including:

- a) The obligation in respect of which the *DN*SP is applying for a waiver;
- b) The reasons why the *DN*SP is applying for the waiver;
- c) Details of the service, or services, in relation to which the *DN*SP is applying for the waiver;
- d) The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates;
- e) Details of the costs associated with the *DN*SP complying with the obligation if the waiver of the obligation were refused;
- f) The *regulatory control period(s)* to which the waiver would apply;
- g) Any additional measures the *DN*SP proposes to undertake if the waiver were granted; and
- h) The reasons why the *DN*SP 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.'

## 5. Grounds for seeking a waiver

### 5.1 Reasons for seeking a waiver

Essential Energy is applying for a waiver of clauses 3.1, 4.2 and 4.4.1(a) of the Guideline as achieving compliance will incur administrative costs that outweigh the benefit or likely benefit to the public.

### 5.2 Reasons for the AER to grant the waiver

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

- i. The National Electricity Objective;
- ii. The potential for cross-subsidisation and discrimination if the waiver is granted or refused;

- iii. 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.'

In addition, in section 5 of the 'Electricity Distribution Ring-fencing Guideline Explanatory Statement November 2016' ('Explanatory Statement') pg55 the AER states 'we will assess waiver applications with respect to the potential for cross-subsidisation, discrimination and with a view to the net benefits in terms of the long term interests of consumers. Our assessment of waiver applications will include consideration of the likely impacts of granting waivers on contestable markets.'

With regards to legal separation waivers specifically the AER goes on to state (pg55): 'There are two specific circumstances in which we are likely to grant a waiver from legal separation obligations. First, in relation to other services provided by a DNSP that are also regulated services, whether regulated by us or by another economic regulator.' In addition, on pg57 the AER specifically calls out 'water network services' as an example of another regulated service where the AER would be inclined to grant a waiver from the legal separation obligations. Page 55 of the Explanatory Statement also notes 'where a waiver from legal separation obligations is granted, we consider that it would usually be appropriate to also grant waivers from office and staff separation obligations and, potentially, obligations restricting co-branding.'

Finally, on page 58 of the Explanatory Statement the AER states: 'In respect of a DNSP providing other services which are also regulated services, such as a DNSP with a gas or water network business, we will only grant a waiver subject to the DNSP agreeing to establish a Cost Allocation Method (CAM) that deals with all of its regulated services.'

Essential Energy's waiver request for the legal separation and functional separation obligations to be waived for the Essential Water business meet the criteria set by the AER for the granting of such a waiver:

- Essential Water is a regulated water network business, regulated by IPART in NSW;
- Essential Energy's CAM covers its whole business including standard control services, alternative control services, Water and unregulated services;
- There is no potential for cross-subsidisation given the whole of business CAM and multiple Regulatory regimes. To maintain compliance with the regulatory requirements of both the Essential Energy and Essential Water businesses separate regulatory accounts for Essential Energy and Essential Water will continue to be produced. This separation will continue because both businesses are operating within different revenue setting and pricing rules. Regulatory accounting separation serves to differentiate the costs of providing services and revenues between the two businesses. Whilst regulatory accounting separation serves as a useful reporting tool, it is also an important means of reducing any opportunities for cost shifting. Accordingly, Essential Energy confirms that it will have in place procedures that will enable the appropriate identification and allocation of costs in accordance with Rules requirements. Essential Energy confirms that it will maintain accounting separation of the Essential Water business from the Essential Energy business, with separate regulatory accounts. The Rules and associated comprehensive AER guidelines for regulatory accounts and the cost allocation methodology maintain sufficient separation and significantly reduce the risk of cross-subsidisation;
- There is no potential for discrimination given the regulated monopoly nature of the Water business;
- There is likely to be no benefit to electricity consumers in Essential Energy complying with the legal separation and functional separation obligations because there would be costs incurred in meeting the obligations that would need to be recouped; and
- There will be no impact on contestable markets in granting the waiver given the monopoly nature of the Water business;
- The granting of the waiver will support the National Electricity Objective given the existence of a whole of business CAM and separate regulation of the Water business versus the costs of adopting the ring fencing provisions.

### 5.3 Cost associated with complying with the obligation under clauses 3.1, 4.2 and 4.4.1(a)

The ring-fencing obligations are an additional layer of regulatory compliance that is not without cost. The additional costs involved with the establishment and operation of a new subsidiary would need to be passed onto consumers. Additional costs related to legal separation include:

- Costs involved in liaising with the NSW government to gain approval for registering a new legal entity;
- One-off costs associated with setting up a new legal entity such as:
  - finance and legal costs associated with the registration of new legal entity;
  - changes to the finance systems, procedures and processes to allow for the financial maintenance of two separate legal entities;
  - taxation grouping requirements;
  - separate governance processes such as Board of Directors and Committees;
  - splitting, transferring or renegotiation of existing contracts and guarantees;
  - bank and debt funding arrangements;
  - changes in payment channels; and
- Ongoing costs associated with the maintenance of two legal entities:
  - The preparation and audit of separate statutory accounts;
  - the preparation and audit of consolidated statutory accounts;
  - separate taxation and associated returns;
  - separate governance processes and internal controls management; and
  - separate transactional processes.

The additional costs involved with the functional separation of the businesses would also need to be passed onto consumers. Additional costs related to functional separation include:

- Costs related to separation of employee office space – this may require partitioning off sections of already leased or owned property or leasing/purchasing new office space. Fit-out costs would be required as well as additional security access measures if partitioning currently leased/owned space. Additional leased or owned office space would also incur additional ongoing costs that would need to be funded by customers/councils;
- Costs related to the separation of staff between regulated activity and the Water business; and
- Costs related to rebranding/advertising – a new brand would need to be created and implemented for either Essential Energy or Essential Water including new website.

### 5.4 Additional measures to be undertaken on granting of waiver

Essential Energy does not propose any additional measures to be undertaken on the granting of this waiver but reaffirms its commitment to the following existing protections:

- Maintenance of a CAM that covers all services offered by the business, including the Essential Water business;
- Maintenance of accounting separation of the Essential Water business; and
- Maintenance of two separate regulatory accounts.



## 6. Summary

Essential Energy submits that a waiver of clauses 3.1, 4.2 and 4.4.1(a) of the Guideline is justified on the basis that:

1. There are no issues of competition given both Essential Energy and Essential Water are both regulated monopolies;
2. The likely public benefits of achieving compliance with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline are negligible or non-existent; and
3. The administrative costs resulting from achieving compliance with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline (that will be avoided if the requirement is waived) outweigh the benefit of achieving compliance.

Essential Energy therefore submits that the granting of a waiver to clauses 3.1, 4.2 and 4.4.1(a) of the Guideline promotes the long-term interests of consumers.

## Appendix 1 - Waiver Information Compliance Checklist

Required Information as per Clause 5.2	Section
The obligation in respect of which the <i>DNISP</i> is applying for a waiver	3.1
The reasons why the <i>DNISP</i> is applying for the waiver	5.1
Details of the service, or services, in relation to which the <i>DNISP</i> is applying for the waiver	2
The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	3.2
Details of the costs associated with the <i>DNISP</i> complying with the obligation if the waiver of the obligation were refused	5.3
The <i>regulatory control period(s)</i> to which the waiver would apply	3.3
Any additional measures the <i>DNISP</i> proposes to undertake if the waiver were granted	5.4
The reasons why the <i>DNISP</i> 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	5.2

# **Ring-Fencing Guideline – Electricity Distribution November 2016**

## **Waiver Application by Essential Energy: Water Access Agreement**

**July 2017**



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## 1. Introduction

This paper outlines Essential Energy's application for a waiver of clauses 3.1, 4.2 and 4.4.1(a) of the Ring Fencing Guideline – Electricity Distribution (Guideline) which prevents a Distribution Network Service Provider (*DNSP*) from providing services other than *distribution services* and *transmission services*.

Essential Energy applies for a waiver of the obligations contained in clauses 3.1, 4.2 and 4.4.1(a) of the Guideline to allow Essential Energy to continue to provide a water access agreement to the Clarence Valley Council without being required to separate the water access agreement service legally or functionally from the regulated Essential Energy business. It is important to note that Essential Energy is currently in discussions with the Council to transfer the assets of the Nymboida Power Station and the water licence to the Council – these discussions are ongoing.

Essential Energy submits that complying with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline, which would require the maintenance of two separate businesses, and the physical separation of staff and offices of the two businesses, would result in increased costs for Essential Energy and Clarence Valley Council customers for no public benefit.

## 2. Description of service – Water Access Agreement with Clarence Valley Council

Essential Energy is the owner of the Nymboida Power Station, a hydroelectric power station located at Nymboida, on the NSW North Coast. The hydroelectric power station and associated infrastructure was commissioned in 1926 and later upgraded in 1937. The Nymboida Hydro-electric Power Station has a high level of heritage significance for its association with the early development of hydro-electric power generation in New South Wales and is listed under Section 170 of the NSW Heritage Act.

In order to operate the power station a water extraction licence has been held since the 1920's under the Water Act 1912 and is used for the extraction of water from the Nymboida River Weir. The water licence is a dual function licence allowing for the extraction of water for the purposes of generating hydro-electric power and the supply of potable water. Due to the allowance for the extraction of potable water the Clarence Valley Council has been utilising the licence and associated water assets, by agreement with Essential Energy and its predecessor organisations, for the supply of potable water to the Grafton / Coffs Harbour regions.

Prior to 2007/08 Clarence Valley Council had been extracting water via the Essential Energy-held licence and associated water assets without charge. In 2007/08 Essential Energy negotiated an access agreement with Clarence Valley Council and instituted a fee to help recover a portion of the costs of the extraction licence, operating, maintenance and repair costs of the common assets used by both Clarence Valley Council and the hydro-electric station. Revenue from this service is approximately \$200,000 per annum.

The hydro-electric power station is at the end of its serviceable life and no longer operating. As a result, Essential Energy is currently in negotiations with the Clarence Valley Council with a view to transferring the licence and associated water assets to the Council.

## 3. Description of waiver being sought

### 3.1 Obligation subject of this waiver

As required by the National Electricity Rules (NER) under clause 6.17.2, the AER published the Ring-Fencing Guideline – Electricity Distribution in November 2016. Clause 6.17.1 of the NER requires *DNSP*'s to comply with the Guideline.

Clause 3.1(b) of the Guideline provides that 'a *DNSP* may provide *distribution services* and *transmission services*, but must not provide *other services*'. Clause 3.1(e) of the Guideline permits a *DNSP* to 'apply for a waiver of the obligations'.

Clauses 4.2 and 4.4.1(a) of the Guideline require DNSP's to functionally separate the offices, staff and branding/cross-promotion of direct control services from contestable electricity services, and ensure any new or varied agreements with service providers include provisions requiring the service provider to comply with the Ring Fencing Guideline. Clauses 4.2.5 and 4.4.2 of the Guideline permit a *DNSP* to apply for a waiver of these obligations.

Essential Energy is seeking a waiver of clauses 3.1, 4.2 and 4.4.1(a) with regards to the water access agreement service offered to Clarence Valley Council.

### 3.2 Proposed waiver commencement date and expiry date

Essential Energy requests that the waiver be granted from 1 December 2016 (the commencement date of the Guideline) with an expiry date of 30 June 2024 (the end of the next regulatory control period) as allowed for by clause 5.3.4(b). These dates have been selected to allow the waiver to be in operation for the longest duration possible given Essential Energy does not foresee any change in the water access agreement service during that timeframe.

### 3.3 Regulatory control periods to which the waiver applies

The requested waiver will cover the remainder of the 2015-2019 regulatory control period as well as the full 2020-2024 regulatory control period.

## 4. Legislative arrangements for waivers

Clause 5.2 states that 'a *DNSP* may apply in writing to the AER for a waiver of its obligations under clauses 3.1, 4.2 and/or 4.4.1(a) of this Guideline'. Furthermore, this clause states 'an application for waiver must contain all information and materials necessary to support the *DNSP*'s application, including:

- a) The obligation in respect of which the *DNSP* is applying for a waiver;
- b) The reasons why the *DNSP* is applying for the waiver;
- c) Details of the service, or services, in relation to which the *DNSP* is applying for the waiver;
- d) The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates;
- e) Details of the costs associated with the *DNSP* complying with the obligation if the waiver of the obligation were refused;
- f) The *regulatory control period(s)* to which the waiver would apply;
- g) Any additional measures the *DNSP* proposes to undertake if the waiver were granted; and
- h) The reasons why the *DNSP* 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.'

## 5. Grounds for seeking a waiver

### 5.1 Reasons for seeking a waiver

Essential Energy is applying for a waiver of clauses 3.1, 4.2 and 4.4.1(a) of the Guideline as achieving compliance will incur administrative costs that outweigh the benefit or likely benefit to the public.

## 5.2 Reasons for the AER to grant the waiver

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

- i. The National Electricity Objective;
- ii. The potential for cross-subsidisation and discrimination if the waiver is granted or refused;
- iii. 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.'

In addition, in section 5 of the 'Electricity Distribution Ring-fencing Guideline Explanatory Statement November 2016' ('Explanatory Statement') pg55 the AER states 'we will assess waiver applications with respect to the potential for cross-subsidisation, discrimination and with a view to the net benefits in terms of the long term interests of consumers. Our assessment of waiver applications will include consideration of the likely impacts of granting waivers on contestable markets.'

Page 9 of the Explanatory Statement provides insight into the justification for Ring Fencing: 'Ring Fencing is the identification and separation of a DNSP's monopoly business activities, costs, revenues and decision making from those associated with providing services in contestable markets.' Pg 11 goes on to state that one of the harms the Guideline is looking to avoid is 'cross-subsidising an affiliate's services in contestable markets with revenue derived from its regulated services'. Chapter 3 of the Explanatory Statement goes on to discuss the measures introduced that target the risk of cross-subsidisation: legal separation, accounting separation and cost allocation.

Page 58 of the Explanatory Statement advises: 'The Guideline itself does not include constraints on our ability to grant waivers from the legal separation obligation because circumstances may arise whereby imposing legal separation would not provide benefits for contestable markets but would impose costs on DNSP's. While we are unable to foresee all such circumstances, we consider that having flexibility to respond to such circumstances will promote the long term interests of electricity consumers, consistent with the National Electricity Objective.' The Statement goes on to say on page 58: 'We expect some waivers will be inconsequential in nature' and 'In assessing a waiver application it is important that we have flexibility in how we choose to assess an application on a case by case basis, to ensure we provide procedural fairness for each application, while minimising unnecessary administrative and compliance burdens.'

Finally, page 55 of the Explanatory Statement also notes 'where a waiver from legal separation obligations is granted, we consider that it would usually be appropriate to also grant waivers from office and staff separation obligations and, potentially, obligations restricting co-branding.'

Essential Energy's waiver request for the legal separation and functional separation obligations to be waived for the water access agreement with Clarence Valley Council meets the criteria set by the AER for the granting of such a waiver:

- The water access agreement with Clarence Valley Council is a monopoly service and only in existence due to the historical ownership of a water licence by Essential Energy. The licence ownership is a result of the former operation of the Nymboida Hydro Power Station and the transition of the provision and supply of electricity to the community, and the Nymboida Hydro Power Station, from Local Councils and private companies to County Councils and finally on to Essential Energy;
- The water access agreement is not a service that is actively promoted or offered to other customers and its existence has no impact on contestable markets. In fact, Essential Energy is currently in discussions with the Council to transfer the assets of the Nymboida Power Station and the water licence to the Council – these discussions are ongoing;
- The revenue from the service, and the costs associated with maintaining it, are immaterial and therefore this waiver application is 'inconsequential in nature' as described on page 58 of the Explanatory Statement;
- Essential Energy's Cost Allocation Method (CAM) covers its whole business including standard control services, alternative control services, Water and unregulated services (which includes the water access agreement);
- The Nymboida Power Station, its related costs, and the water access agreement are accounted for separately to standard control and alternative control services in Essential Energy's financial system;

- There is no potential for discrimination given the regulated monopoly nature of the access agreement;
- There is likely to be no benefit to electricity consumers in Essential Energy complying with the legal separation and functional separation obligations but there would be costs incurred in meeting the obligations that would need to be recouped;
- The granting of the waiver will support the National Electricity Objective given the existence of a whole of business CAM, the accounting separation of the Nymboida Power Station, and the immaterial nature of the water access agreement service versus the costs of adopting the ring fencing provisions.

### 5.3 Cost associated with complying with the obligation under clauses 3.1, 4.2 and 4.4.1(a)

The ring-fencing obligations are an additional layer of regulatory compliance that is not without cost. The additional costs involved with the establishment and operation of a new subsidiary would need to be passed onto the Clarence Valley Council and their rate payers and Essential Energy customers. Such additional costs relating to legal separation include:

- Costs involved in liaising with the NSW government to gain approval for registering a new legal entity;
- One-off costs associated with setting up a new legal entity such as:
  - finance and legal costs associated with the registration of new legal entity;
  - changes to the finance systems, procedures and processes to allow for the financial maintenance of two separate legal entities;
  - taxation grouping requirements;
  - separate governance processes such as Board of Directors and Committees;
  - splitting, transferring or renegotiation of existing contracts and guarantees;
  - bank and debt funding arrangements;
  - changes in payment channels; and
- Ongoing costs associated with the maintenance of two legal entities:
  - The preparation and audit of separate statutory accounts;
  - the preparation and audit of consolidated statutory accounts;
  - separate taxation and associated returns;
  - separate governance processes and internal controls management; and
  - separate transactional processes.

The additional costs involved with the functional separation of the businesses would also need to be passed onto consumers. Additional costs related to functional separation include:

- Costs related to separation of employee office space – this may require partitioning off sections of already leased or owned property or leasing/purchasing new office space. Fit-out costs would be required as well as additional security access measures if partitioning currently leased/owned space. Additional leased or owned office space would also incur additional ongoing costs that would need to be funded by customers/councils;
- Costs related to the separation of staff between regulated activity and the water access agreement activity; and
- Costs related to rebranding/advertising – a new brand would need to be created and implemented for the water access agreement activity.



## 5.4 Additional measures to be undertaken on granting of waiver

Current measures in place include:

- the maintenance of a CAM that covers all services offered by the business, including the water access agreement with Clarence Valley Council; and
- the accounting separation of the Nymboida hydro-power station, its related costs, and the water access agreement.

Given the immaterial nature of the water access agreement Essential Energy does not propose any additional measures to be undertaken on the granting of this waiver.

## 6. Summary

Essential Energy submits that a waiver of clauses 3.1, 4.2 and 4.4.1(a) of the Guideline is justified on the basis that:

1. There are no issues of competition given only Essential Energy can provide the water access required to Clarence Valley Council due to ownership of the water licence (and noting that Essential Energy is currently in discussions with the Council to transfer the assets of the Nymboida Power Station and the water licence to the Council);
2. The likely public benefits of achieving compliance with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline are negligible or non-existent given the existence of a whole of business CAM that ensures costs are allocated fairly between all services; and
3. The administrative costs resulting from achieving compliance with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline (that will be avoided if the requirement is waived) outweigh the benefit of achieving compliance.

Essential Energy therefore submits that the granting of a waiver to clauses 3.1, 4.2 and 4.4.1(a) of the Guideline promotes the long-term interests of consumers.

## Appendix 1 - Waiver Information Compliance Checklist

Required Information as per Clause 5.2	Section
The obligation in respect of which the <i>DNISP</i> is applying for a waiver	3.1
The reasons why the <i>DNISP</i> is applying for the waiver	5.1
Details of the service, or services, in relation to which the <i>DNISP</i> is applying for the waiver	2
The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	3.2
Details of the costs associated with the <i>DNISP</i> complying with the obligation if the waiver of the obligation were refused	5.3
The <i>regulatory control period(s)</i> to which the waiver would apply	3.3
Any additional measures the <i>DNISP</i> proposes to undertake if the waiver were granted	5.4
The reasons why the <i>DNISP</i> 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	5.2

# **Ring-Fencing Guideline – Electricity Distribution November 2016**

## **Waiver Application by Essential Energy: Residual Contestable Meters**

**July 2017**



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## 1. Introduction

This paper outlines Essential Energy's application for a waiver of clauses 4.2 and 4.4.1(a) of the Ring Fencing Guideline – Electricity Distribution (Guideline) which requires a Distribution Network Service Provider (DNSP) to comply with obligations relating to physical separation, staff separation, branding and cross promotion and office and staff registers between its *direct control services* and *contestable electricity services* provided by a *related electricity service provider*.

Essential Energy applies for a waiver of the obligations contained in clauses 4.2 and 4.4.1(a) of the Guideline to allow Essential Energy to continue to provide a residual type 4 contestable meter service for the small number of remaining type 4 meters without being required to comply with these obligations until Essential Energy is able to transfer all remaining sites and exit the market completely. As a result, the waiver is only transitional in nature. Note that the timing for the transfer of these meters is dependent on action from the Retailers.

Essential Energy submits that complying with clauses 4.2 and 4.4.1(a) of the Guideline, which would require the separation of offices, staff and branding/promotion of the residual type 4 contestable meter service from regulated offices, staff and branding/promotion, and amendments to any new or varied agreements with service providers, would result in increased costs for customers for no public benefit.

## 2. Description of service – Residual Type 4 Contestable Meters

In 2015/16 Essential Energy derived gross income of approximately \$0.7 million from the provision of metering systems outside of those regulated as a direct control service. This income primarily relates to type 4 metering systems. These remain as a legacy from when Essential Energy's predecessor organisations provided type 4 metering on a contestable basis, or in providing metering systems on a contractual basis under legacy connection agreements. Essential Energy has been progressively unwinding these arrangements over time, but some still remain. Essential Energy made the decision to fully withdraw from this service and continues to reduce the number of meters within this service.

At this stage Essential Energy believes there will be a very small number of type 4 meters remaining on our books at January 1, 2018. These meters fall into three different categories:

- De-energised meters – we currently maintain control of 39 de-energised meters where there are no current active customers. Of these, 34 are meters with 2G communications systems which are no longer supported and are unable to be read remotely. Essential Energy is currently billing retailers for the remaining five meters and we are expecting that Retailers will transfer these over to their own metering co-ordinators at some stage. Market rules mean that all active National Meter Identifiers (NMIs) require a meter and as such Essential Energy is unable to remove these meters unless the NMI is made extinct / abolished. It is unlikely that this will occur prior to January 1, 2018;
- Active meters – Essential Energy currently services 66 active meters, 40 of which contain 2G communications and can no longer be remotely read. We have advised retailers that we are expecting them to replace these meters. Essential Energy does not currently charge for these meters. Fees for the remaining 26 meters are still being charged to retailers. We are waiting on retailers, as the Responsible Person (RP) for these sites, to churn these meters over to their own metering providers at some point but are dependent on the retailer for action for these meters to be removed from our books;
- Generators – we currently have 8 NMI's for metering equipment for measuring the volume of electricity injected into the network from a number of different generators. These meters are located within Essential Energy substations. Essential Energy has previously requested Retailers churn these meters away from Essential Energy but to date this has not occurred.

### 3. Description of waiver being sought

#### 3.1 Obligation subject of this waiver

As required by the National Electricity Rules (NER) under clause 6.17.2, the Australian Energy Regulator (AER) published the Ring-Fencing Guideline – Electricity Distribution in November 2016. Clause 6.17.1 of the NER requires *DNSP*s to comply with the Guideline.

The clauses within section 4.2 of the Guideline require *DNSP*'s to functionally separate the offices, staff and branding/cross-promotion of direct control services from contestable electricity services. Clause 4.41(a) also requires any new or varied agreements with service providers include provisions requiring the service provider to comply with the Ring Fencing Guideline. Clauses 4.2.5 and 4.4.2 of the Guideline permit a *DNSP* to apply for a waiver of these obligations.

Essential Energy is seeking a waiver of clauses 4.2 and 4.4.1(a) with regards to the residual type 4 contestable meter service. It is important to note that this is a transitional waiver with expectations that Retailers will take responsibility for the remaining meters away from Essential Energy prior to the cessation of this waiver. However, the timing of this activity is dependent on retailer action.

#### 3.2 Proposed waiver commencement date and expiry date

Essential Energy requests that the waiver be granted from 1 December 2016 (the commencement date of the Guideline) with an expiry date of 30 June 2019. These dates have been selected to give time for retailers to take responsibility for the remaining meters away from Essential Energy.

#### 3.3 Regulatory control periods to which the waiver applies

The requested waiver will cover the remainder of the 2015-2019 regulatory control period.

### 4. Legislative arrangements for waivers

Clause 5.2 states that 'a *DNSP* may apply in writing to the AER for a waiver of its obligations under clauses 3.1, 4.2 and/or 4.4.1(a) of this Guideline'. Furthermore, this clause states 'an application for waiver must contain all information and materials necessary to support the *DNSP*'s application, including:

- a) The obligation in respect of which the *DNSP* is applying for a waiver;
- b) The reasons why the *DNSP* is applying for the waiver;
- c) Details of the service, or services, in relation to which the *DNSP* is applying for the waiver;
- d) The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates;
- e) Details of the costs associated with the *DNSP* complying with the obligation if the waiver of the obligation were refused;
- f) The *regulatory control period(s)* to which the waiver would apply;
- g) Any additional measures the *DNSP* proposes to undertake if the waiver were granted; and
- h) The reasons why the *DNSP* 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.'

## 5. Grounds for seeking a waiver

### 5.1 Reasons for seeking a waiver

Essential Energy is applying for a waiver of clauses 4.2 and 4.4.1(a) of the Guideline as achieving compliance will incur administrative costs that outweigh the benefit or likely benefit to the public as Essential Energy is no longer competing in this market and has been actively withdrawing for several years.

### 5.2 Reasons for the AER to grant the waiver

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

- i. The National Electricity Objective;
- ii. The potential for cross-subsidisation and discrimination if the waiver is granted or refused;
- iii. 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.'

In addition, on page 57 of the 'Electricity Distribution Ring-fencing Guideline Explanatory Statement November 2016' ('Explanatory Statement') the AER states 'in considering whether to grant a waiver from the Guideline's non-discrimination obligations, we will consider a range of issues. These include:

- Whether a waiver would better achieve the National Electricity Objective;
- The potential for cross-subsidisation and discrimination if the waiver is granted;
- The benefits of the relevant obligation for the long term interests of consumers;
- The costs to the DNSP of its compliance with the obligation;
- The effect of granting a waiver on competition in markets for contestable electricity services.'

The Explanatory Statement goes on to say on page 58: 'We expect some waivers will be inconsequential in nature' and 'In assessing a waiver application it is important that we have flexibility in how we choose to assess an application on a case by case basis, to ensure we provide procedural fairness for each application, while minimising unnecessary administrative and compliance burdens.'

Essential Energy's request for the functional separation obligations to be waived for the residual type 4 contestable meter service meets the criteria set by the AER for the granting of a waiver for the following reasons:

- The granting of the waiver will support the National Electricity Objective as the service is immaterial, with Essential Energy already having largely withdrawn from the market over the last couple of years. The waiver is only transitional in nature to give Retailers time to take responsibility for the remaining meters away from Essential Energy. The National Electricity Objective is further protected by the existence of a whole of business Cost Allocation Method (CAM) and accounting separation of the service whilst Essential Energy finalises the withdrawal from this service;
- There is no potential for discrimination given Essential Energy has already decided to exit the contestable metering market;
- There is likely to be no benefit to electricity consumers in Essential Energy complying with the functional separation obligations for the provision of residual type 4 contestable meter services as Essential has already withdrawn from this service;
- The costs of compliance with the obligation is likely to be considerable. Meeting the obligation would require costs to be incurred in a number of different areas including the separation of staff managing the service from staff conducting regulated activity and new office accommodation (or expense refitting existing office accommodation) as well as a rebranding exercise and possible IT costs;

- There will be no impact on contestable markets should this waiver be granted given Essential Energy has already withdrawn from competing in the market; and
- Essential Energy has requested on numerous occasions that the responsible retailers take responsibility for the remaining contestable meters – however, the transfer of these sites is dependent on action from retailers, not Essential Energy.

### 5.3 Cost associated with complying with the obligation under clause 4.2

The ring-fencing obligations are an additional layer of regulatory compliance that is not without cost. The additional costs involved with the functional separation of the residual type 4 contestable meter service would need to be passed onto the remaining customers. Such additional costs include:

- Costs related to separation of employee office space – this may require partitioning off sections of already leased or owned property or leasing/purchasing new office space. Fit-out costs would be required as well as additional security access measures if partitioning currently leased/owned space. Additional leased or owned office space would also incur additional ongoing costs that would need to be funded by customers;
- Costs related to the separation of staff between regulated activity and the residual type 4 contestable meter service – costs would be incurred in separating out employees to manage the business. Given the geographic dispersion of the remaining meters, and the low volume of activity, it would be difficult for Essential Energy to efficiently deliver this service as a standalone business; and
- Costs related to rebranding/advertising – a new brand would need to be created and implemented for the residual type 4 contestable meter service including new website.

### 5.4 Additional measures to be undertaken on granting of waiver

Essential Energy does not propose any additional measures to be undertaken on the granting of this waiver but reaffirms its commitment to the maintenance of a CAM that covers all services offered by the business, including the residual type 4 contestable meter service, and the accounting separation of the service in Essential Energy's financial system.

## 6. Summary

Essential Energy submits that a waiver of clauses 4.2 and 4.4.1(a) of the Guideline is justified on the basis that:

1. There are no issues of competition given Essential Energy no longer competes in this market;
2. The likely public benefit of achieving compliance with clauses 4.2 and 4.4.1(a) of the Guideline are negligible or non-existent; and
3. The administrative costs resulting from achieving compliance with clauses 4.2 and 4.4.1(a) of the Guideline (that will be avoided if the requirement is waived) outweigh the benefit of achieving compliance, especially considering the progressive withdrawal of Essential Energy from the service.

Essential Energy therefore submits that the granting of a waiver to clauses 4.2 and 4.4.1(a) of the Guideline promotes the long-term interests of consumers.



## Appendix 1 - Waiver Information Compliance Checklist

Required Information as per Clause 5.2	Section
The obligation in respect of which the <i>DNISP</i> is applying for a waiver	3.1
The reasons why the <i>DNISP</i> is applying for the waiver	5.1
Details of the service, or services, in relation to which the <i>DNISP</i> is applying for the waiver	2
The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	3.2
Details of the costs associated with the <i>DNISP</i> complying with the obligation if the waiver of the obligation were refused	5.3
The <i>regulatory control period(s)</i> to which the waiver would apply	3.3
Any additional measures the <i>DNISP</i> proposes to undertake if the waiver were granted	5.4
The reasons why the <i>DNISP</i> 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	5.2

# Ring-Fencing Guideline – Electricity Distribution November 2016

## Waiver Application by Essential Energy: LED Streetlighting

July 2017



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## 1. Introduction

This paper outlines Essential Energy's application for a waiver of clauses 4.2 and 4.4.1(a) of the Ring Fencing Guideline – Electricity Distribution (Guideline) which requires a Distribution Network Service Provider (DNSP) to comply with obligations relating to physical separation, staff separation, branding and cross promotion and office and staff registers between its *direct control services* and *contestable electricity services* provided by a *related electricity service provider*.

Essential Energy applies for a waiver of the obligations contained in clauses 4.2 and 4.4.1(a) of the Guideline to allow Essential Energy to provide a LED Streetlighting service without being required to comply with these obligations until the 2020-2024 Classification of Services comes into effect, whereupon the service will be reclassified as an alternative control service (see Service Group 'Public Lighting' in the *AER – Preliminary framework and approach for NSW electricity distributors 2019-24 – March 2017*). As a result, the waiver is transitional in nature until the 2019-24 Classification of Services comes into force.

Essential Energy submits that complying with clauses 4.2 and 4.4.1(a) of the Guideline, which would require the separation of offices, staff and branding/promotion of the LED Streetlighting service from regulated offices, staff and branding/promotion, and amendments to any new or varied agreements with service providers, would result in increased costs for customers for no public benefit.

## 2. Description of service – LED Streetlighting

In Essential Energy's distribution network area, there are approximately 150,000 in-service streetlights serving almost 100 Local Government Areas who represent more than 800,000 homes and businesses across NSW. Of these streetlights, Essential Energy is responsible for maintaining approximately 149,000 (more than 99 per cent).

Essential Energy's objectives in providing public lighting are to:

- Meet public lighting customer and local community needs for effective lighting, reliability, energy efficiency and environmental performance;
- Maintain a safe public lighting system that is compliant with AS/NZS 1158;
- Fulfil regulatory requirements as well as those of NSW Department of Industry, including the NSW Public Lighting Code (the Code); and
- Minimise the costs to Essential Energy and our public lighting customers.

Light Emitting Diode (LED) streetlights are evolving around the world as a technology that can meet these objectives. Major benefits include reliability improvements for maintenance and energy savings for the customer.

Following successful trials with Category P lighting (pedestrian areas), Essential Energy has added category P LED lighting to our standard materials lists. This provides LED lighting options for new lighting installations and an opportunity to upgrade existing installations to a more efficient lighting technology over time.

Essential Energy does not have an Australian Energy Regulator (AER) approved Street Light Use of System (SLUOS) price for LED technology. Following discussions with the AER, it was confirmed Essential Energy would need to initially introduce LED lighting as a Negotiated Distribution Service until an approved regulated SLUOS price can be provided by the AER as part of our next regulatory determination.

## 3. Description of waiver being sought

### 3.1 Obligation subject of this waiver

As required by the National Electricity Rules (NER) under clause 6.17.2, the AER published the Ring-Fencing Guideline – Electricity Distribution in November 2016. Clause 6.17.1 of the NER requires DNSP's to comply with the Guideline.

The clauses within sections 4.2 and 4.4.1(a) of the Guideline require DNSP's to functionally separate the offices, staff and branding/cross-promotion of direct control services from contestable electricity services, and ensure any new or varied agreements with service providers include provisions requiring the service provider to comply with the Ring Fencing Guideline. Clause 4.2.5 and 4.4.2 of the Guideline permit a *DN*SP to apply for a waiver of these obligations.

Essential Energy is seeking a waiver of clauses 4.2 and 4.4.1(a) with regards to the LED Streetlighting service.

### 3.2 Proposed waiver commencement date and expiry date

Essential Energy requests that the waiver be granted from 1 December 2016 (the commencement date of the Guideline) with an expiry date of 30 June 2019 (the end of the current regulatory control period). These dates have been selected to allow the waiver to be in operation until Essential Energy's 2020-2024 Classification of Services comes into effect whereupon the LED Streetlighting service will be reclassified as an alternative control service.

### 3.3 Regulatory control periods to which the waiver applies

The requested waiver will cover the remainder of the 2015-2019 regulatory control period only.

## 4. Legislative arrangements for waivers

Clause 5.2 states that 'a *DN*SP may apply in writing to the AER for a waiver of its obligations under clauses 3.1, 4.2 and/or 4.4.1(a) of this Guideline. Furthermore, this clause states an application for waiver must contain all information and materials necessary to support the *DN*SP's application, including:

- a) The obligation in respect of which the *DN*SP is applying for a waiver;
- b) The reasons why the *DN*SP is applying for the waiver;
- c) Details of the service, or services, in relation to which the *DN*SP is applying for the waiver;
- d) The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates;
- e) Details of the costs associated with the *DN*SP complying with the obligation if the waiver of the obligation were refused;
- f) The *regulatory control period(s)* to which the waiver would apply;
- g) Any additional measures the *DN*SP proposes to undertake if the waiver were granted; and
- h) The reasons why the *DN*SP 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.'

## 5. Grounds for seeking a waiver

### 5.1 Reasons for seeking a waiver

Essential Energy is applying for a waiver of clauses 4.2 and 4.4.1(a) of the Guideline as achieving compliance will incur administrative costs that outweigh the benefit or likely benefit to the public. The reclassification of the service as an alternative control service starting 1 July 2019 will make this service fully compliant with the Guideline at that time.

### 5.2 Reasons for the AER to grant the waiver

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

- i. The National Electricity Objective;
- ii. The potential for cross-subsidisation and discrimination if the waiver is granted or refused;
- iii. 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.'

In addition, on page 57 of the 'Electricity Distribution Ring-fencing Guideline Explanatory Statement November 2016' ('Explanatory Statement') the AER states 'in considering whether to grant a waiver from the Guideline's non-discrimination obligations, we will consider a range of issues. These include:

- Whether a waiver would better achieve the National Electricity Objective;
- The potential for cross-subsidisation and discrimination if the waiver is granted;
- The benefits of the relevant obligation for the long term interests of consumers;
- The costs to the DNSP of its compliance with the obligation;
- The effect of granting a waiver on competition in markets for contestable electricity services.'

The Explanatory Statement goes on to say on page 58: 'We expect some waivers will be inconsequential in nature' and 'In assessing a waiver application it is important that we have flexibility in how we choose to assess an application on a case by case basis, to ensure we provide procedural fairness for each application, while minimising unnecessary administrative and compliance burdens.'

Essential Energy's waiver request for the functional separation obligations to be waived for the LED Streetlighting service meets the criteria set by the AER for the granting of a waiver for the following reasons:

- The Preliminary Framework and Approach document released by the AER in March 2017 included 'emerging public lighting technology' as an alternative control service within the Public Lighting service group (page 95). Page 30 of the Preliminary Framework and Approach document also states: 'we also propose to include emerging public lighting technology as part of the public lighting services group. Emerging public lighting technology relates to luminaries that the NSW distributors do not provide at the time of our distribution determination. However, emerging public lighting technology may become available during the 2019-24 regulatory control period'. Note that Essential Energy is well advanced in its plans to provide emerging public lighting technology and installation of LED lights is already underway;
- The granting of the waiver will support the National Electricity Objective as the proposed reclassification to alternative control will result an appropriate level of regulation being applied to protect consumers and result in no ring fencing obligations for the LED Streetlighting service. The National Electricity Objective is further protected until the reclassification by the existence of a whole of business Cost Allocation Method (CAM) and accounting separation of the LED Streetlights service within Essential Energy's financial system;
- There is no potential for discrimination given the regulatory framework that DNSP's operate under in the delivery of this service and the AER is proposing to classify this service as an alternative control service;
- Customers will benefit from the reclassification of the service to alternative control as an appropriate level of regulation will be applied to the pricing of this service. Should the waiver not be granted it is likely Essential Energy would delay the provision of this service as the costs of functional separation (including a rebranding exercise) would far outweigh the returns the service will generate between now and the beginning of the next Regulatory period. This would not be in the interests of consumers (or their councils) as there are cost and environmental benefits in the installation of this technology that would be delayed. As such, there is likely to be no benefit to electricity consumers in Essential Energy complying with the functional separation obligations for the provision of LED Streetlighting services;
- The costs of compliance with the obligation is likely to be considerable. Meeting the obligation would require costs to be incurred in a number of different areas including the separation of staff managing the service from staff conducting regulated activity and new office accommodation (or expense refitting existing office accommodation) as well as a rebranding exercise and possible IT costs. These costs would need to be recouped (or written-off) over the two financial years between gaining full compliance with the Ring Fencing Guideline and reclassification of the service as an alternative control service. As a result, the most

likely approach from Essential Energy should the waiver not be approved is to delay the provision of this service;

- There is likely to be no impact on contestable markets should this waiver be granted given the lack of competition currently in the market.

### 5.3 Cost associated with complying with the obligation under clauses 4.2 and 4.4.1(a)

The ring-fencing obligations are an additional layer of regulatory compliance that is not without cost. The additional costs involved with the functional separation of the LED Streetlighting Service would need to be passed onto the customers. Such additional costs include:

- Costs related to separation of employee office space – this may require partitioning off sections of already leased or owned property or leasing/purchasing new office space. Fit-out costs would be required as well as additional security access measures if partitioning currently leased/owned space. Additional leased or owned office space would also incur additional ongoing costs that would need to be funded by customers/councils;
- Costs related to the separation of staff between regulated activity and LED Streetlighting – costs would be incurred in separating out an employee to manage the business. The role would likely not be a full-time role; and
- Costs related to rebranding/advertising – a new brand would need to be created and implemented for the LED Streetlighting service including new website.

### 5.4 Additional measures to be undertaken on granting of waiver

Essential Energy does not propose any additional measures to be undertaken on the granting of this waiver but reaffirms its commitment to the maintenance of a CAM that covers all services offered by the business, including the LED Streetlighting service, and accounting separation of the service in Essential Energy's financial system.

## 6. Summary

Essential Energy submits that a waiver of clauses 4.2 and 4.4.1(a) of the Guideline is justified on the basis that:

1. There are no issues of competition given the barriers to entry in providing this service and the resulting lack of competition as highlighted by the AER's intent to reclassify the service as Alternate Control as per the Service Group 'Public Lighting' in the *AER – Preliminary framework and approach for NSW electricity distributors 2019-24 – March 2017*– as such, Essential Energy maintains that reclassification as an alternative control service provides the best approach for customers;
2. The likely public benefits of achieving compliance with clauses 4.2 and 4.4.1(a) of the Guideline are negligible or non-existent. In fact, the likely impact would be a delay for customers/councils in being able to access the benefits provided by the new technology; and
3. The administrative costs resulting from achieving compliance with clauses 4.2 and 4.4.1(a) of the Guideline (that will be avoided if the requirement is waived) outweigh the benefit of achieving compliance, especially considering the reclassification of this service as an alternative control service from 1 July, 2019.

Essential Energy therefore submits that the granting of a waiver to clauses 4.2 and 4.4.1(a) of the Guideline promotes the long-term interests of consumers.

## Appendix 1 - Waiver Information Compliance Checklist

Required Information as per Clause 5.2	Section
The obligation in respect of which the <i>DNISP</i> is applying for a waiver	3.1
The reasons why the <i>DNISP</i> is applying for the waiver	5.1
Details of the service, or services, in relation to which the <i>DNISP</i> is applying for the waiver	2
The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	3.2
Details of the costs associated with the <i>DNISP</i> complying with the obligation if the waiver of the obligation were refused	5.3
The <i>regulatory control period(s)</i> to which the waiver would apply	3.3
Any additional measures the <i>DNISP</i> proposes to undertake if the waiver were granted	5.4
The reasons why the <i>DNISP</i> 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	5.2



# **Ring-Fencing Guideline – Electricity Distribution November 2016**

## **Waiver Application by Essential Energy: Nightvision Service**

**July 2017**



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## 1. Introduction

This paper outlines Essential Energy's application for a waiver of clauses 4.2 and 4.4.1(a) of the Ring Fencing Guideline – Electricity Distribution (Guideline) which requires a Distribution Network Service Provider (*DNSP*) to comply with obligations relating to physical separation, staff separation, branding and cross promotion and office and staff registers between its *direct control services* and *contestable electricity services* provided by a *related electricity service provider*.

Essential Energy applies for a waiver of the obligations contained in clauses 4.2 and 4.4.1(a) of the Guideline to allow Essential Energy to continue to provide the Night Vision service without being required to comply with these obligations until the 2020-2024 Classification of Services comes into effect, whereupon the service is proposed to be reclassified as an alternative control service (see Service Group 'Networks Safety Services' in the *AER – Preliminary framework and approach for NSW electricity distributors 2019-24 – March 2017*). As a result, the waiver is transitional in nature until the 2019-24 Classification of Services comes into force.

Essential Energy submits that complying with clauses 4.2 and 4.4.1(a) of the Guideline, which would require the separation of offices, staff and branding/promotion of the Night Vision service from regulated offices, staff and branding/promotion, and amendments to any new or varied agreements with service providers, would result in significantly increased costs for customers for no public benefit.

## 2. Description of service – Night Vision

"Night Vision" is a service provided by Essential Energy that provides floodlighting to illuminate areas that do not have adequate "public lighting". Typical examples include installation of floodlights on poles to improve the security of a commercial business, illuminating public monuments and heritage buildings, or to provide lighting of a car park. Night Vision lighting is operated between the hours of dusk and dawn each day. The Night Vision lights are generally installed on existing distribution poles / structures, with all lighting equipment remaining the property of Essential Energy.

Whilst Essential Energy runs the Night Vision service on a commercial basis, it is not a service which is aggressively marketed or driven for growth / large commercial returns. Essential Energy presently provides Night Vision services to approximately 800 premises across our distribution network. This service is generally provided as a community service upon request of customers. The service is not marketed or advertised outside of a small space on our website that notes the offering.

## 3. Description of waiver being sought

### 3.1 Obligation subject of this waiver

As required by the National Electricity Rules (NER) under clause 6.17.2, the Australian Energy Regulator (AER) published the Ring-Fencing Guideline – Electricity Distribution in November 2016. Clause 6.17.1 of the NER requires *DNSP*'s to comply with the Guideline.

The clauses within sections 4.2 and 4.4.1(a) of the Guideline require *DNSP*'s to functionally separate the offices, staff and branding/cross-promotion of direct control services from contestable electricity services, and ensure any new or varied agreements with service providers include provisions requiring the service provider to comply with the Ring Fencing Guideline. Clauses 4.2.5 and 4.4.2 of the Guideline permit a *DNSP* to apply for a waiver of these obligations.

Essential Energy is seeking a waiver of clauses 4.2 and 4.4.1(a) with regards to the Night Vision service.

### 3.2 Proposed waiver commencement date and expiry date

Essential Energy requests that the waiver be granted from 1 December 2016 (the commencement date of the Guideline) with an expiry date of 30 June 2019 (the end of the current regulatory control period). These dates have been selected to allow the waiver to be in operation until Essential Energy's 2020-2024 Classification of Services comes into effect whereupon the Night Vision service is proposed to be reclassified as an alternative control service.

### 3.3 Regulatory control periods to which the waiver applies

The requested waiver will cover the remainder of the 2015-2019 regulatory control period only.

## 4. Legislative arrangements for waivers

Clause 5.2 states that 'a *DN*SP may apply in writing to the AER for a waiver of its obligations under clauses 3.1, 4.2 and/or 4.4.1(a) of this Guideline'. Furthermore, this clause states 'an application for waiver must contain all information and materials necessary to support the *DN*SP's application, including:

- a) The obligation in respect of which the *DN*SP is applying for a waiver;
- b) The reasons why the *DN*SP is applying for the waiver;
- c) Details of the service, or services, in relation to which the *DN*SP is applying for the waiver;
- d) The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates;
- e) Details of the costs associated with the *DN*SP complying with the obligation if the waiver of the obligation were refused;
- f) The *regulatory control period(s)* to which the waiver would apply;
- g) Any additional measures the *DN*SP proposes to undertake if the waiver were granted; and
- h) The reasons why the *DN*SP 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.'

## 5. Grounds for seeking a waiver

### 5.1 Reasons for seeking a waiver

Essential Energy is applying for a waiver of clauses 4.2 and 4.4.1(a) of the Guideline as achieving compliance will incur administrative costs that outweigh the benefit or likely benefit to the public. The proposed reclassification of the service as an alternative control service starting 1 July 2019 will make this service fully compliant with the Guideline at that time.

### 5.2 Reasons for the AER to grant the waiver

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

- i. The National Electricity Objective;
- ii. The potential for cross-subsidisation and discrimination if the waiver is granted or refused;
- iii. Whether the benefit, or likely benefit, to electricity consumers of the *DN*SP complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the *DN*SP of complying with that obligation.'

In addition, on page 57 of the 'Electricity Distribution Ring-fencing Guideline Explanatory Statement November 2016' ('Explanatory Statement') the AER states 'in considering whether to grant a waiver from the Guideline's non-discrimination obligations, we will consider a range of issues. These include:

- Whether a waiver would better achieve the National Electricity Objective;
- The potential for cross-subsidisation and discrimination if the waiver is granted;
- The benefits of the relevant obligation for the long term interests of consumers;
- The costs to the DNSP of its compliance with the obligation;
- The effect of granting a waiver on competition in markets for contestable electricity services.'

The Explanatory Statement goes on to say on page 58: 'We expect some waivers will be inconsequential in nature' and 'In assessing a waiver application it is important that we have flexibility in how we choose to assess an application on a case by case basis, to ensure we provide procedural fairness for each application, while minimising unnecessary administrative and compliance burdens.'

Essential Energy's waiver request for the functional separation obligations to be waived for the Night Vision service meets the criteria set by the AER for the granting of a waiver for the following reasons:

- The Preliminary Framework and Approach document released by the AER in March 2017 argues that public lighting should remain classified as an alternative control service (pages 30-31): '*We consider there to be significant barriers preventing third parties from providing public lighting services. While the NSW distributors do not have a legislative monopoly over these services, a monopoly position exists. This is because the NSW distributors own the majority of public lighting assets. That is, other parties would need access to poles and easements for instance to hang their own public lighting assets. However, the NSW distributors own and control such supporting infrastructure. Therefore, similar to common distribution services, ownership of network assets restricts the operation, maintenance, alteration or relocation of public lighting services to NSW distributors. There is some limited scope for other parties to provide some public lighting services...apart from these limited exceptions, we consider that a high barrier prevents third parties from entering this market. This limits competition in public lighting and results in the NSW distributors possessing significant market power.*'
- Service Group 'Networks Safety Services' in the AER – *Preliminary framework and approach for NSW electricity distributors 2019-24 – March 2017* includes 'night watch (private security and flood lighting services) in the Further Description column and highlights the AER's intent to reclassify this service as Alternative Control;
- The granting of the waiver will support the National Electricity Objective as the proposed reclassification to alternative control will result in an appropriate level of regulation being applied to protect consumers and will result in the removal of all ring fencing obligations for the Night Vision service. The National Electricity Objective is further protected until the reclassification by a whole of business Cost Allocation Method (CAM) and accounting separation of the Night Vision service within Essential Energy's financial system;
- There is no potential for discrimination given the regulatory framework that DNSP's operate under in the delivery of this service;
- Customers will benefit from the reclassification of the service to alternative control as an appropriate level of regulation will be applied to the pricing of this service. Should the waiver not be granted it is likely Essential Energy would discontinue this service as the costs of functional separation (including a rebranding exercise) would far outweigh the current commercial returns on the service, especially as we are proposing to reclassify the service as alternative control (i.e. the costs would not be able to be recouped across the two financial years prior to the reclassification). This would not be in the interests of consumers as there are natural barriers for third parties to enter the market and, should a player enter the market to offer the service, which is highly geographically dispersed, it will likely be at a higher price. There is likely to be no benefit to electricity consumers in Essential Energy complying with the functional separation obligations;
- The costs of compliance with the obligation is likely to be considerable. Meeting the obligation would require costs to be incurred in a number of different areas including the separation of staff managing the service from staff conducting regulated activity and new office accommodation (or expense refitting existing

office accommodation) as well as a rebranding exercise and possible IT costs. As managing the service does not require a full-time role it would increase the costs to deliver the service on an ongoing basis. These costs would need to be recouped (or written-off) over the two financial years between gaining full compliance with the Ring Fencing Guideline and reclassification of the service as an alternative control service. As a result, the most likely approach from Essential Energy should the waiver not be approved is to discontinue the service;

- There is likely to be no impact on contestable markets should this waiver be granted given the lack of competition currently in the market.

### 5.3 Cost associated with complying with the obligation under clauses 4.2 and 4.4.1(a)

The ring-fencing obligations are an additional layer of regulatory compliance that is not without cost. The additional costs involved with the functional separation of the Night Vision Service would need to be passed onto the customers. Such additional costs include:

- Costs related to separation of employee office space – this may require partitioning off sections of already leased or owned property or leasing/purchasing new office space. Fit-out costs would be required as well as additional security access measures if partitioning currently leased/owned space. Additional leased or owned office space would also incur additional ongoing costs that would need to be funded by customers;
- Costs related to the separation of staff between regulated activity and Night Vision – significant additional costs would be incurred if the sharing of regulated field staff from Night Vision field staff were required. Currently field staff from across our footprint are allocated to the installation of new lighting or the maintenance / relocation of existing lighting in their local depot area. However, the volume of activity is minimal in each location and doesn't support a full-time field employee. Given Essential Energy does not have any other contestable service to keep these employees occupied the service could only support a very small number of full-time field staff from a commercial basis. As such, costs would increase due to the additional travel time for these staff to access jobs outside of their direct location and there would likely be significant amounts of downtime between jobs (hence the likelihood of Essential Energy discontinuing the service if the waiver were not granted). If field staff could be shared, costs would still be incurred in separating out an employee to manage the business – a job which also would not currently fully occupy a single full time equivalent role; and
- Costs related to rebranding/advertising – a new brand would need to be created and implemented for the Night Vision service including a new website.

### 5.4 Additional measures to be undertaken on granting of waiver

Essential Energy does not propose any additional measures to be undertaken on the granting of this waiver but reaffirms its commitment to the maintenance of a CAM that covers all services offered by the business, including the Night Vision service, and accounting separation of the Night Vision service.

## 6. Summary

Essential Energy submits that a waiver of clauses 4.2 and 4.4.1(a) of the Guideline is justified on the basis that:

1. There are no issues of competition given the barriers to entry in providing this service and the resulting lack of competition as highlighted by the AER's intent to reclassify the service as Alternate Control as per the Service Group 'Networks Safety Services' in the *AER – Preliminary framework and approach for NSW electricity distributors 2019-24 – March 2017*;
2. The likely public benefits of achieving compliance with clauses 4.2 and 4.4.1(a) of the Guideline are negligible or non-existent; and
3. The administrative costs resulting from achieving compliance with clauses 4.2 and 4.4.1(a) of the Guideline (that will be avoided if the requirement is waived) outweigh the benefit of achieving compliance, especially considering the reclassification of this service as an alternative control service from 1 July, 2019.

Essential Energy therefore submits that the granting of a waiver to clauses 4.2 and 4.4.1(a) of the Guideline promotes the long-term interests of consumers.

## Appendix 1 - Waiver Information Compliance Checklist

Required Information as per Clause 5.2	Section
The obligation in respect of which the <i>DNISP</i> is applying for a waiver	3.1
The reasons why the <i>DNISP</i> is applying for the waiver	5.1
Details of the service, or services, in relation to which the <i>DNISP</i> is applying for the waiver	2
The proposed commencement date and expiry date (if any) of the waiver and the reasons for those dates	3.2
Details of the costs associated with the <i>DNISP</i> complying with the obligation if the waiver of the obligation were refused	5.3
The <i>regulatory control period(s)</i> to which the waiver would apply	3.3
Any additional measures the <i>DNISP</i> proposes to undertake if the waiver were granted	5.4
The reasons why the <i>DNISP</i> 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	5.2