

30 October 2017

Mr Chris Pattas  
General Manager Networks  
Australian Energy Regulator

By email: [ringfencing@aer.gov.au](mailto:ringfencing@aer.gov.au)

Dear Chris

### Application for waiver from AER Ring-fencing Guideline – Legal Separation: Other Services maintenance and construction contracts

SA Power Networks has a number of existing infrastructure maintenance and construction contracts with large customers which have post 1 January 2018 completion dates. Under the AER's Ring-Fencing Guideline (**guideline**) we interpret these contracts as SA Power Networks providing non-distribution services – which can no longer be provided by distribution network service providers (**distributors**) after 1 January 2018. Future contracts of this nature will be entered into by our newly-formed affiliate Enerven Energy Infrastructure Pty Ltd.

To comply with the guideline we had intended to negotiate, with each of the customers involved, the transfer of these existing contracts to Enerven Energy Infrastructure Pty Ltd (**Enerven**), prior to 1 January 2018.

However, we have advice that such transfers could create tax liabilities which exceed the cost-pass-through threshold. To mitigate this risk, we have sought a Private Binding Ruling from the Australian Taxation Office (**ATO**). We have not yet secured this ruling and it is becoming more likely that a ruling, and the subsequent requisite negotiations with customers, will not be able to be successfully completed before 1 January 2018.

We are therefore now requesting a short-term waiver from the legal obligations listed in section 3.1 of the guideline in respect of these contracts until 30 September 2018. Granting of a waiver for this period will allow SA Power Networks to continue to provide these contracted services, until either:

- These contracts terminate. That is, many of these contracts will terminate prior to 30 September 2018 whereby no negotiation and transfer would be required; or
- The ATO has provided us with a favourable ruling allowing us to commence customer negotiations and, subject to successful conclusion, effect transfers to Enerven without incurring tax liabilities; or
- The ATO has provided us with an unfavourable Ruling at which point we will consider whether further waiver(s) or some other course of action is appropriate.

Our application (attached) is set out according to the requirements listed in section 5.2 of the guideline. Our contact for this application is Samantha Hicks, 08 8404 4194.

Yours sincerely



Wayne Lissner  
**A/General Manager Corporate Strategy**

## **SA Power Networks' application for waiver from AER Ring-fencing guideline – Legal Separation: Other Services (maintenance and construction contracts)**

### **Details of the services in relation to which the distributor is applying for the waiver**

This waiver application relates to 20 'other services' maintenance and construction contracts. These contracts are listed in confidential Attachment A. These contracts have been executed by SA Power Networks and will involve the provision of 'other services' beyond 1 January 2018. The guideline does not permit SA Power Networks to provide 'other services' after 1 January 2018.

### **The obligation in respect of which the distributor is applying for a waiver**

In respect of these 20 contracts only, SA Power Networks is applying for a waiver from the legal separation obligations listed in Section 3.1 of the guideline.

### **The reasons why the distributor is applying for the waiver**

The reasons SA Power Networks is applying for this waiver are:

- ***Cost and efficiency***

As described in the cover letter to this application, transfer of these contracts prior to receiving a favourable ruling from the Australian Taxation Office could result in SA Power Networks incurring significant additional ring-fencing costs associated with any ultimate tax liabilities. Any additional taxation costs would exceed the cost pass through threshold.

SA Power Networks has not been funded for any ring-fencing costs and we have also recently incurred other significant and new compliance costs including major IT system costs required for metering contestability from 1 December 2017, significant network repair costs following a record number of severe weather events in 2016/17 requiring a record number of guaranteed service level payments to customers (which exceeded \$25 million in 2016/17) and other recent National Electricity Rules (NER) changes which further increase our reporting requirements and costs. In view of these costs and the quantum of significant tax liabilities we would be seeking a pass-through for tax liabilities that arise from ring-fencing.

- ***No cross-subsidisation or discrimination***

Not imposing legal separation for these contracts for a short-term period will not in any way advantage an SA Power Networks affiliate, as these are contracts already won in competitive markets and for services which are currently being provided. SA Power Networks will still be subject to other guideline obligations.

SA Power Networks' Cost Allocation Method (CAM) addresses the risk of cross-subsidisation. We will continue to allocate and attribute costs as required in accordance with the CAM and cost allocation procedures, in accordance with NER requirements.

Functional separation measures will still be applied to the services provided under these contracts, in line with guideline obligations. SA Power Networks considers that the functional separation that will be thus achieved will be a sufficient measure in the short-term to avoid any adverse impact with respect to its obligations not to discriminate. We will comply with all of the functional separation obligations, avoiding any opportunity to discriminate. The services and their provision will be fully in compliance with the guideline. If the provision of these contracted services is undertaken by any staff who also provide direct control services, or from locations which also deliver direct control services, these will be published on the appropriate registers.

Delivery of these services has already been re-branded as Enerven.



- **The proposed commencement date and expiry date of the waiver and reasons for those dates**

The proposed commencement is as soon as granted by the AER and no later than 1 January 2018. The proposed expiry date would be 30 September 2018, to allow the ATO to conclude its private tax ruling deliberations; SA Power Networks to negotiate with relevant customers for contract transfer to Enerven; and subject to successful negotiations, transfer the contracts to Enerven.

**Details of the costs associated with the distributor complying with the obligation if the waiver of the obligation were refused**

If we assign contracts or assets prior to the ATO issuing a Private Binding Ruling on taxation, there is a risk that for each contract, tax liabilities could be payable. These costs would be substantial, and would exceed the cost pass-through threshold.

**The regulatory control period to which the waiver would apply**

The waiver would apply for part of the existing current regulatory control period, from 1 January 2018 to 30 September 2018.

**Any additional measures the distributor proposes to undertake if the waiver were granted**

SA Power Networks is undertaking a substantial ring-fencing implementation project to work towards guideline compliance by 1 January 2018.

We have already established new entities to comply with legal separation requirements, and will meet all other legal separation obligations by 1 January 2018.

As soon as the ATO provides their ruling, we would commence negotiations and our planned transfer of contracts to Enerven.

**The reasons why the distributor 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**

With reference to the three matters in 5.3.2(a) of the guideline:

**i. the National Electricity Objective;**

Granting of the waiver will enable SA Power Networks to comply with the guideline and avoid potentially unnecessary and significant cost for SA Power Networks' regulated customers. The proposed waiver will promote efficient operation and use of electricity services for the long-term interests of electricity customers, specifically in regard to a lower price. If the waiver is not granted and a cost pass-through to customers is approved for any tax liabilities, this will not be in the long-term interests of consumers as a higher price would arise, with no off-setting benefits to customers of any kind.

**ii. the potential for cross-subsidisation and discrimination if the waiver is granted or refused;**

SA Power Networks maintains separate accounts for its regulated and other services to capture and isolate the direct costs incurred in providing these services and allocates costs to these services in accordance with the CAM. These services are not cross-subsidised.

With respect to discrimination, the contracts in question have already been won in competitive markets, so no discrimination is feasible as a result of their operation under the waiver. Also, functional separation obligations will still be met with respect to delivery of these contracts, ensuring the potential for discrimination is eliminated. This includes the operational delivery of these services already being branded as Enerven.

**iii. whether the benefit, or likely benefit, to electricity consumers of the distributor complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the distributor of complying with that obligation.**

In respect of these 20 contracts, we do not believe there is any benefit to consumers in requiring SA Power Networks to comply with the obligation by 1 January 2018. Granting this short-term waiver will neither discriminate against existing competitors nor lessen competition for future work. The taxation liabilities that could flow to SA Power Networks and (subject to a successful cost pass through application) ultimately to our customers from enforcement of the obligation by the AER from 1 January far outweigh any conceivable perceived benefit of not granting the waiver.