



Draft Decision

**Ergon Energy Application for Waiver of
Certain Ring-Fencing Arrangements**

May 2010

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SUBMISSIONS

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority. Therefore submissions are invited from interested parties concerning its assessment of an application for the waiver of certain ring-fencing arrangements by Ergon Energy. The Authority will take account of all submissions received.

Written submissions should be sent to the address below. While the Authority does not necessarily require submissions in any particular format, it would be appreciated if two printed copies are provided together with an electronic version on disk (Microsoft Word format) or by e-mail. Submissions, comments or inquiries regarding this paper should be directed to:

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The closing date for submissions is 24 June 2010.

Confidentiality

In the interests of transparency and to promote informed discussion, the Authority would prefer submissions to be made publicly available wherever this is reasonable. However, if a person making a submission does not want that submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two copies of each version of these submissions (i.e. the complete version and another excising confidential information) could be provided. Again, it would be appreciated if each version could be provided on disk. Where it is unclear why a submission has been marked “confidential”, the status of the submission will be discussed with the person making the submission.

While the Authority will endeavour to identify and protect material claimed as confidential as well as exempt information and information disclosure of which would be contrary to the public interest (within the meaning of the *Right to Information Act 2009* (RTI)), it cannot guarantee that submissions will not be made publicly available. As stated in s187 of the *Queensland Competition Authority Act 1997* (the QCA Act), the Authority must take all reasonable steps to ensure the information is not disclosed without the person’s consent, provided the Authority is satisfied that the person’s belief is justified and that the disclosure of the information would not be in the public interest. Notwithstanding this, there is a possibility that the Authority may be required to reveal confidential information as a result of a RTI request.

Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at the Brisbane office of the Authority, or on its website at www.qca.org.au. If you experience any difficulty gaining access to documents please contact the office (07) 3222 0555.

Information about the role and current activities of the Authority, including copies of reports, papers and submissions can also be found on the Authority’s website.

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1. INTRODUCTION

On 13 April 2010, Ergon Energy Corporation Limited (Ergon Energy) applied to the Authority for a waiver from section 1(b) of the *Electricity Distribution: Ring-Fencing Guidelines* (the Guidelines) in respect of a one megawatt generator in the Barcaldine region, which Ergon Energy claims will only be used for network support. Section 1(b) requires that Distribution Network Service Providers (DNSP's) not carry on a related business, such as generation or retail, within the same legal entity as their network business.

In accordance with the Guidelines, the Authority placed notices calling for submissions on Ergon Energy's waiver application in the *Courier Mail* and the *Australian* newspapers on 24 April 2010. Submissions closed on 10 May 2010 and no submissions were received by the Authority.

Following consideration of Ergon Energy's application and the provisions of the Authority's Guidelines, the Authority is releasing this Draft Decision indicating its intention to issue a notice under section 21 of the Guidelines, to waive Ergon Energy's requirement to comply with section 1(b) with respect to its Barcaldine network support generator.

The Authority seeks submissions in response to its Draft Decision. Any submission should be received by the Authority by 24 June 2010. A Final Decision will be released in July 2010.

2. RING-FENCING GUIDELINES

The Authority's Ring-fencing Guidelines were released in September 2000. The objective of the Guidelines was to underpin an environment where the price, quantity and quality of electricity traded in the retail, generation and distribution markets was not biased due to vertical integration of distribution and other businesses. At the same time, the Authority was mindful of the potential for capturing activities where the cost imposed by complying with the Guidelines could outweigh the benefit, or any likely benefit, to the public.

2.1 Procedures for waving ring-fencing obligations

Section 1 of the Guidelines details the minimum ring-fencing obligations of Queensland DNSPs. Apart from the obligation for legal separation, the Guidelines require that DNSPs have separate accounting and marketing arrangements for related businesses and have arrangements to ensure that confidential information is not misused.

Section 21 of the Guidelines gives a DNSP the right to seek a waiver from its obligations under section 1. Where a DNSP applies for a waiver of any of its ring-fencing obligations, the Authority must follow the procedures defined in sections 22 to 30 of the Guidelines. These require that the Authority seek public submissions on the ring-fencing waiver application, issue a Draft Decision, seek comments on the Draft Decision and then issue a Final Decision. These procedures have been reproduced in full in Appendix A.

In accordance with section 27 of the Guidelines, the Authority is now issuing a Draft Decision.

3. ERGON ENERGY'S WAIVER APPLICATION

On 13 April 2010, Ergon Energy applied to the Authority for an exemption from section 1(b) of the Guidelines, which requires that a DNSP must not carry on a related business within the same legal entity as its network business. A related business is defined as “the business of purchasing or selling electricity”.

In support of its waiver application, Ergon Energy has stated that:

- (a) the National Electricity Rules (the Rules) permit the use of generation as an alternative to augmenting the distribution network;
- (b) it can be technically and economically more efficient to operate generation sites, as opposed to augmenting the existing network, in order to provide reliable performance of its long rural distribution feeders;
- (c) the *Electricity Act 1994* and Electricity Regulations provide that Ergon may use generation sites in order to fulfill its obligation of ensuring electricity supply;
- (d) grid-connected generation sites used for network support are not used for entering either the generation or retail markets and have no impact on the National Electricity Market;
- (e) there are significant costs associated with establishing a separate legal entity in which to house the grid-connected generator. Ergon Energy has indicated that the establishment of a separate legal entity as would otherwise be required under the Guidelines would cost \$11,700 to set up and a further \$157,900 per annum to operate. Irrespective of where these services are legally housed, there is no offsetting public benefit. Therefore, according to Ergon Energy, the costs must outweigh the benefits; and
- (f) the Authority previously granted similar waivers for four grid-connected generation assets used for network support in February 2004 and in September 2001 with respect to isolated generation assets.

In closing its argument Ergon Energy stated:

that this Waiver application is reasonable on the grounds that the extra costs, bureaucracy and complexity to remove Network Support Grid-Connected Generation into a separate legal entity to the one that is providing prescribed distribution services is not commensurate with the benefits to be derived (if any) to the public and that the use of these assets by a distribution network service provider complies with the provisions and intent of the Rules and the Queensland legislation.

Ergon Energy's full waiver application can be found on the Authority's website.

4. AUTHORITY POSITION

The Authority generally considers the requirement for legal separation a necessary aspect of the regulation of DNSPs. It is particularly important for the effective separation of any upstream or downstream business activities from the monopoly business and reinforcing the Authority's commitment to eliminate cross-subsidies, enforce stringent accounting separation and eliminate incentives to undertake anti-competitive behaviour.

However, the Authority considers that each case should be judged on its merits and, having considered Ergon Energy's arguments, the Authority accepts that, in this case, Ergon Energy would incur some administrative costs in complying with the requirements of the Guidelines. While these costs would not be substantial in terms of the overall costs of a distribution business, they would ultimately be reflected in distribution tariffs.

The Authority also considers that there would be no apparent public benefit from requiring Ergon Energy to house the Barcardine generator in a separate legal entity. The Barcardine generator is not to be used to enter the generation market and, as a result, is unlikely to have any negative impact on competitive outcomes in these markets. Rather, the generator is being used solely to supply a prescribed distribution service.

The Authority also notes that, following the introduction of full retail competition in the Queensland electricity market, Ergon Energy's remaining retail business is no longer permitted to actively compete in the retail market but is required to continue to act much as a retailer of last resort for customers unable, or unwilling, to enter into competitive market contracts with other retailers. As such, the possibility that Ergon Energy as a vertically integrated business might misuse its position as a monopoly distribution service provider to act in an uncompetitive manner is largely diminished and hence a principal purpose of the requirement for legal separation of related businesses is also largely removed.

Having considered Ergon Energy's application, the Authority is of the view that requiring Ergon Energy to comply with the legal separation requirements of the Guidelines in this particular case would not achieve a public benefit sufficient to offset Ergon Energy's compliance costs. Rather, the Authority considers that Ergon Energy's choice to utilise network support generation in this remote location, in preference to augmenting the distribution network, would potentially reduce costs to consumers.

The Authority is therefore inclined to approve the current waiver application, a view consistent with its past decisions in similar circumstances.

If this decision is confirmed in the Authority's Final Decision, the Barcardine generator would remain subject to all other aspects of the Guidelines.

5. DRAFT DECISION

The Authority's Draft Decision is to issue a notice under section 21 of the Guidelines to waive Ergon Energy's requirement to comply with section 1(b) of the Ring-fencing Guidelines, with respect to Ergon Energy's Barcaldine network support generator.

In accordance with section 27(b) of the Guidelines, the Authority requests any submissions on this Draft Decision be received by no later than 24 June 2010.

6. APPENDIX A**Procedure for Waiving Ring-Fencing Obligations¹**

23. A DNSP may apply to the QCA requesting the QCA to issue a notice under section 21.
24. When the QCA receives an application under section 22 the QCA must:
 - (a) if it considers that the application has been made on trivial or vexatious grounds, reject the application without further consideration; or
 - (b) in all other cases within 14 days after receipt of the application, inform each person known to the QCA who the QCA believes has a sufficient interest in the matter that it has received the application by publishing a notice in a national daily newspaper which at least:
 - (i) states who the DNSP concerned is and the obligations that the application seeks to have waived;
 - (ii) states how copies of the application can be obtained; and
 - (iii) requests submissions by a date specified in the notice (not being a date earlier than 14 days after the date of the notice).
25. The QCA must provide a copy of the application to any person within 7 days after the person requests a copy and pays any reasonable fee required by the QCA.
26. The QCA must consider any submissions received by the date specified in the notice published under section 23 and it may (but is not obliged to) consider any submissions received after that date.
27. Within 30 days after the last day for submissions specified in the notice published under section 23 the QCA must issue a Draft Decision stating whether or not it intends to issue a notice under section 21.
28. The QCA must:
 - (a) provide a copy of its Draft Decision to the DNSP, any person who made a submission on the matter and any other person who requests a copy; and
 - (b) request submissions from persons to whom it provides the Draft Decision by a specified date (not being a date earlier than 14 days after the date the Draft Decision was issued).
29. The QCA must consider any submissions it receives by the date specified by the QCA under section 27 and it may (but is not obliged to) consider any submissions received after that date.
30. Within 30 days after the last day for submissions on the Draft Decision specified by the QCA, the QCA must issue a Final Decision stating whether or not it will issue a notice under section 21.
31. A notice under section 21 has effect 14 days after the notice is given to the DNSP or such later date as the QCA specifies in the notice.

¹ Queensland Competition Authority, *Final Determination: Electricity Distribution: Ring-Fencing Guidelines*, September 2000, pp. 24-25.