



Final Decision

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

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PREAMBLE

On 13 April 2010, Ergon Energy applied for a waiver of section 1(b) of the *Electricity Distribution: Ring-Fencing Guidelines 2000* (the Guidelines) in relation to a one megawatt grid connected network support generator in the Barcaldine Region.

The Authority issued a Draft Decision on 20 May 2010 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) of the Guidelines, with respect to Ergon Energy's Barcaldine network support generator.

No submissions were received in response to the Draft Decision and no other new information has been received to suggest that an alternative course of action would be appropriate. Therefore, the Authority's Final Decision confirms the position proposed in its Draft Decision which 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 Guidelines, with respect to Ergon Energy's Barcaldine network support generator.

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1. INTRODUCTION

The Authority's Ring-fencing Guidelines aim to underpin an environment where the price, quantity and quality of electricity traded in retail, generation and distribution markets is not biased due to the structure of Queensland's distribution network service providers (DNSPs). 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.

1.1 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 29 of the Guidelines, the Authority is now issuing its Final Decision.

2. 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 Energy may use generation sites in order to fulfil 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.

On 24 April 2010, the Authority placed a notice in the Courier Mail and the Australian, calling for public submissions on the waiver application by Ergon Energy. Submissions closed on 10 May 2010. Ergon Energy's application was also made available to the public on the Authority's website.

No submissions on Ergon Energy's application were received.

2.1 Draft Decision

Following consideration of the Ergon application, the provisions of the Guidelines, the *Electricity Act 1994* and the National Electricity Rules, on 20 May 2010, the Authority released a Draft Decision under section 26 of the Guidelines indicating its intention to waive Ergon Energy's requirement to comply with ring-fencing obligations 1(b) of the Guidelines in respect of Ergon Energy's Barcaldine network support generator.

2.2 Submission in Response to Draft Decision

Submissions on the Authority's Draft Decision closed on 24 June 2010. No submissions were received in response to the Draft Decision.

3. AUTHORITY POSITION

In its Draft Decision, the Authority noted that it generally considers the requirement for legal separation a necessary aspect of the regulation of DNSPs. It is particularly important where monopoly and other business activities are conducted by the one enterprise, in order to eliminate cross-subsidies, enforce stringent accounting separation and eliminate incentives to undertake anti-competitive behaviour.

However, the Authority considered that each case should be judged on its merits and, having considered Ergon Energy's arguments, the Authority accepted that, in this case, Ergon Energy would incur 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 considered that there was no apparent public benefit from requiring Ergon Energy to house the Barcaldine generator in a separate legal entity. The Barcaldine 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 noted 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. 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 was of the view in the Draft Decision 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 considered 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 was therefore inclined to approve the current waiver application, a view consistent with its past decisions in similar circumstances.

4. FINAL DECISION

No submissions have been received in response to its Draft Decision nor has any new information come to light to suggest that an alternative course of action would be appropriate. Therefore, there is no reason to change the Authority's position outlined in its Draft Decision.

The Authority's Final Decision (issued in accordance with section 29 of the Guidelines) 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 Guidelines, with respect to Ergon Energy's Barcaldine network support generator.

Ergon Energy's activities will remain subject to all other aspects of the Guidelines and section 1(b) will continue to apply to any other relevant activities of Ergon Energy.

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

A DNSP may apply to the QCA requesting the QCA to issue a notice under section 21.

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).

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.

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.

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.

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).

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.

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.

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 Guideline*, September 2000.