



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

Final Decision

February 2007

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1. EXECUTIVE SUMMARY

The Authority's Electricity Distribution Ring-fencing Guidelines require that a distribution network service provider (DNSP) ensure that confidential information either provided by a customer or obtained by the DNSP in the course of conducting its business is not disclosed to any employee, consultant or agent of an Associate of the DNSP. Furthermore, a DNSP is required to ensure that its marketing staff are not also staff of an Associate. These obligations are contained in sections 1(f), 1(g) and 1(i) of the Ring-fencing Guidelines.

The Queensland Government is currently in the process of selling its retail electricity business 'Powerdirect Australia', which is to incorporate, amongst other things, the contestable customers previously attached to Ergon Energy Proprietary Limited.

Ergon Energy Proprietary Limited's current franchise customers are to be transferred to a new entity called Ergon Energy Queensland (EEQ), which is to be a fully owned subsidiary of Ergon Energy Corporation Limited (Ergon Energy or EECL). As such, EEQ will be an Associate of Ergon Energy.

EEQ is to operate as a service delivery retailer but will not be permitted to compete for customers in the contestable retail market. That is, EEQ will not be able to participate in full retail competition (FRC). EEQ will be limited to offering the Standard Retail Contract to existing franchise customers and new franchise customers (that is, those connecting for the first time in Ergon Energy's supply area) at the Government's gazetted tariff. Franchise customers that are housed in EEQ will be able to choose to move to market contracts with other retailers but will not be permitted to revert back to EEQ at a later date. Customers of other retailers will not be able to choose EEQ as their retailer.

Ergon Energy applied for a waiver from the requirements of sections 1(f), 1(g) and 1 (i) of the Authority's Ring-fencing Guidelines in respect of the franchise retail customers retained by EEQ on the grounds that, following the sale, it will no longer be able to participate in the contestable retail market and that the administrative costs of complying with these particular ring-fencing obligations would outweigh any public benefit arising from meeting the obligations.

The Authority placed a notice in the *Australian Financial Review* and the *Courier Mail* calling for submissions on the application to be lodged with the Authority no later than 24 November 2006. Three submissions were received.

Following consideration of Ergon Energy's application and the submissions received, the Authority issued a Draft Decision indicating its intention to issue a notice to waive Ergon Energy's requirement to comply with section 1(f), 1(g) and 1(i) of the Authority's Ring-fencing Guidelines in respect of Ergon Energy's association with EEQ.

Submissions were sought on the Draft Decision by 29 January 2007. No submissions were received.

As there have been no objections to granting the waiver and no new information has been presented that would change the Authority's view as outlined in its Draft Decision, the Authority has decided to approve Ergon Energy's waiver application and issue a notice under section 21 of the Guidelines to waive Ergon's requirement to comply with ring-fencing obligations section 1(f), 1(g) and 1(i) of the Authority's Ring-fencing Guidelines in respect of Ergon Energy's association with EEQ.

2. INTRODUCTION

The Authority's Electricity Distribution: Ring-fencing Guidelines were released in September 2000, prescribing Ring-fencing Guidelines to apply to DNSPs. The objective of the Guidelines was to underpin an environment where the price, quantity and quality of electricity traded in the retail market, and the price, quantity and quality of distribution services used to deliver the energy, were not biased due to the vertical integration of distribution and other businesses, particularly retail activities.

At the same time, the Authority was also mindful of the potential for capturing activities where the costs imposed by complying with the Guidelines could outweigh the benefit, or any likely benefit, to the public.

2.1 Procedures for waiving ring-fencing obligations

Section 1 of the Authority's Ring-fencing Guidelines detail the minimum ring-fencing obligations imposed on Queensland DNSPs. A DNSP also has the right to seek a waiver from any of its obligations under section 1. This right is provided under section 21 of the Guidelines which states:

The QCA may, by notice to a DNSP, waive any of a DNSP's obligations under section 1 provided that the QCA is satisfied that the DNSP can demonstrate that the administrative cost to the DNSP and its Associates of complying with the obligation outweighs the benefit, or any likely benefit, to the public.

Where a DNSP applies for waiver of any of its ring-fencing obligations, the Authority must follow the procedures defined in sections 22 to 30 of the Guidelines. These procedures have been reproduced at Appendix A.

In accordance with section 29 of the Guidelines, the Authority is now issuing its Final Decision.

3. ERGON ENERGY'S APPLICATION

On 13 October 2006, Ergon Energy applied to the Authority for an exemption from sections 1(f), 1(g) and 1(i) of the Authority's Ring-fencing Guidelines which relate to the management of confidential information and the allocation of marketing staff between Ergon Energy and EEQ.

The sections of the Guidelines that Ergon Energy has sought a waiver from are as follows:

- 1(f) ensure that all confidential information provided by a customer or prospective customer is used only for the purpose for which that information was provided and that such information is not disclosed to any employee, consultant, independent contractor or agent of an Associate or any other person without the approval of the customer or prospective customer who provided it, except:
 - i. if the confidential information comes into the public domain otherwise than by disclosure by the DNSP; or
 - ii. to comply with any law, any legally binding order of a court, government, government or semi-government authority or administrative body or the listing rules of any relevant recognised stock exchange;
- 1(g) ensure that all confidential information obtained by the DNSP or by its employees, consultants, independent contractors or agents in the course of conducting its business and which might reasonably be expected to affect materially the commercial interests of a customer or prospective customer is not disclosed to any employee, consultant, independent contractor or agent of an Associate or any other person without the approval of the customer or prospective customer to whom that information pertains, except:
 - i. if the confidential information comes into the public domain otherwise than by disclosure by the DNSP; or
 - ii. to comply with any law, any legally binding order of a court, government, government or semi-government authority or administrative body or the listing rules of any relevant recognised stock exchange;
- 1(i) ensure that its marketing staff are not also staff of an Associate that takes part in a related business and, in the event that they become or are found to be involved in a related business contrary to this section, must ensure their immediate removal from its marketing staff.

In support of its waiver application, Ergon Energy pointed out that EEQ will be a service delivery retailer rather than a commercial retailer and will be restricted by legislation from participating in the competitive retail market. EEQ will be limited to supplying electricity at the gazetted tariffs.

For this reason, Ergon Energy argued that there could be no benefit, or likely benefit, in requiring it to maintain information restrictions as there would be no incentive or

opportunity for EEQ to use such information in a way that would hinder other market participants from competing on a fair and equal basis.

Ergon Energy indicated that, in order to comply with sections 1(f) and 1(g), administrative costs of around \$200,000 per year would be incurred. However, Ergon Energy claimed that there would be no additional benefit either financial or otherwise that would accrue to the public from managing customer information in the manner required under these sections of the Guidelines.

With respect to section 1(i) concerning marketing staff, Ergon Energy highlighted that the Energy Competition Committee has advised Ergon Energy that, under the new Electricity Industry Code, Ergon Energy marketing staff would be viewed as no longer being able to provide services that could be construed as benefiting a commercial retail operation.

In closing their argument Ergon Energy stated:

We wish to highlight that, through this waiver application, EECL is not seeking relief from its obligations to maintain financial or legal ring-fencing or to share confidential information beyond EECL and EEQ.

On 1 November 2006, the Authority placed a notice in the *Australian Financial Review* and the *Courier Mail*, calling for public submissions on the waiver application by Ergon Energy by no later than 24 November 2006. Ergon Energy's application was also made available to the public on the Authority's web site and parties who had registered their interest in such matters with the Authority were advised by email that the application had been received.

The Authority received three submissions on Ergon Energy's application.

3.1 Submission Received

Submissions were received from the Energy Competition Committee (EEC), the Queensland Consumer's Association and the Department of Mines and Energy (DME). Each supported Ergon Energy's application for a ring-fencing waiver, noting that EEQ will not be a competitive retailer.

The EEC highlighted the fact that the prohibition on competitive retail activity by EEQ will be reinforced by the fact that, once a customer moves from EEQ to a retail contract with another retailer, the customer will not be permitted to revert back to EEQ. Therefore, EEQ has no incentive to seek or use customer information for any competitive advantage since it may only sell electricity at notified prices to customers who have not chosen to go to the market.

The submission received from the Queensland Consumers Association also supported Ergon Energy's application on the basis that all contestable customers will be transferred to Powerdirect Australia which will be separated from Ergon Energy.

The DME supported Ergon Energy's application on the basis that the confidential information obligations of the Guidelines were no longer required given the legislative and organisational changes associated with the sale of the retail electricity business. The DME also acknowledged that allowing the waiver would reduce unnecessary compliance costs.

The Authority also received a response from the Australian Energy Regulator which advised that Ergon Energy's application did not cause it any concern and, for this reason, it did not intend to make a formal submission.

3.2 Draft Decision

Following consideration of the Ergon application, the provisions of the Authority's Ring-fencing Guidelines, the Electricity Act 1994 and the National Electricity Rules (the Rules), on 21 December 2006, the Authority released a Draft Decision under section 26 of the Ring-fencing Guidelines indicating its intention to waive Ergon's requirement to comply with ring-fencing obligations 1(f), 1(g) and 1(i) of the Authority's Ring-fencing Guidelines in respect of Ergon's relationship with EEQ.

It is important to note that under this Decision, Ergon Energy's other activities will remain subject to all aspects of the Ring-Fencing Guidelines. Ergon Energy will continue to be required to separate assets, costs and accounting records to identify those attributable to Ergon Energy and EEQ.

3.3 Submission in Response to Draft Decision

Submissions on the Authority's Draft Decision were sought by no later than 29 January 2006.

No submissions were received in response to the Draft Decision.

4. QCA ANALYSIS AND POSITION

In its Draft Decision, the Authority accepted that EEQ will be restricted from participating in the contestable retail market with no provision for customers to revert back to EEQ once they have accepted a market contract with another retailer. Under this arrangement, there would be no opportunity for EEQ to misuse information that would otherwise be protected by sections 1(f) and 1(g) of the Ring-fencing Guidelines to gain an unfair commercial or competitive advantage over other retailers.

Continuing to apply the confidential information provisions in this instance will cause additional costs to be incurred as Ergon Energy restructures. These costs would have to be borne by EEQ's customers. However, there does not appear any off-setting benefit to the public, either financially or otherwise, from continuing these ring-fencing arrangements.

Section 1(i) of the guidelines would appear to be superfluous as, under the new Electricity Industry Code, Ergon Energy marketing staff would be viewed as no longer being able provide services that could be construed as benefiting a related commercial retail operation.

The Authority generally considers the requirement to manage the flow of confidential customer information to be an important element in its ring-fencing provisions and necessary to eliminate any incentive for a vertically integrated entity to engage in anti-competitive behaviour. However, the Authority considers that each case should be judged on its merits and, in this instance, there appears no benefit, or likely benefit, to the public by requiring Ergon Energy to comply with sections 1(f), 1(g) and 1(i) of the Ring-fencing Guidelines in its association with EEQ.

It is important to note that Ergon Energy's activities will remain subject to all other aspects of the Ring-Fencing Guidelines and that sections 1(f), 1(g) and 1(i) will continue to apply to any other relevant activities of Ergon Energy. Ergon Energy will continue to be required to separate assets, costs and accounting records, to identify those attributable to Ergon Energy and EEQ.

Having considered Ergon Energy's application, the initial submissions from stakeholders and having received no submissions in response to its Draft Decision objecting to the grant of a waiver, the Authority confirms its position as proposed in its Draft Decision that the waiver should be approved.

5. FINAL DECISION

The Authority's Final Decision (issued in accordance with section 29 of the Ring-fencing Guidelines) is to issue a notice under section 21 of the Ring-fencing Guidelines to waive Ergon's requirement to comply with ring-fencing obligations section 1(f), 1(g) and 1(i) of the Authority's Ring-fencing Guidelines in respect of Ergon Energy's association with EEQ.

It is important to note that Ergon Energy's activities will remain subject to all other aspects of the Ring-Fencing Guidelines and that sections 1(f), 1(g) and 1(i) will continue to apply to any other relevant activities of Ergon Energy. Ergon Energy will continue to be required to separate assets, costs and accounting records, to identify those attributable to Ergon Energy and EEQ.

Appendix A

Procedure for Waiving Ring-Fencing Obligations¹

22. A DNSP may apply to the QCA requesting the QCA to issue a notice under section 21.
23. 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;
 - (iii) requests submissions by a date specified in the notice (not being a date earlier than 14 days after the date of the notice).
24. 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.
25. 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.
26. 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.
27. 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).
28. 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.
29. 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.

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

30. 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.