

# Ring-fencing Guideline – Electricity Distribution: Version 3, November 2021

8.05B Application by Essential Energy  
to maintain waiver: Essential Water

January 2023



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## 1. Introduction

This is our application to the Australian Energy Regulator (AER) to maintain our existing waiver in relation to our Essential Water business. We are requesting 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*.

In applying for a waiver of these obligations, it will allow us to continue to manage the Essential Water business without being required to separate that business legally or functionally from the regulated Essential Energy business.

We submit that complying with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline would require us to maintain two separate businesses and physically separate the staff and offices of the two businesses. This would increase 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. Our area of operation as a water supply authority is land within the local government area of the Broken Hill City Council; the Stephens Creek, Umberumberka 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's water and sewerage functions came under the *Water Management Act 2000*, and subsequent general and water supply authorities' regulations.

In 2003, the name was changed to Australian Inland. This 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 Broken Hill and the surrounding region under the umbrella of a State Owned Corporation electricity business. In March 2006, the trading name was changed again, to Country Water, better reflecting the Water business's functions.

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 around 10,500 customers in Broken Hill, Menindee, Sunset Strip and Silverton. In addition, it provides sewerage services to Broken Hill. The sections below provide an overview of these services.

### 2.2 Water supply services

Essential Energy supplies about 5,470 ML of water per year to around 10,000 residential customers and 500 non-residential customers in the Broken Hill area. We also provide non-potable water to around 50 rural users along the Menindee to Broken Hill pipeline for stock and domestic purposes. The following is a breakdown of our 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, before any treatment process, or water that is 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 wastewater that is treated at a sewage 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 about 9,700 customers in the city of Broken Hill, including to some houses and other buildings in the Perilya mining lease area. We operate two sewage treatment plants, from which 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. We provide a range of miscellaneous services to the city's water and sewerage services 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 charged on an as-needed basis.

## 3. Description of waiver being sought

### 3.1 Obligation subject of this waiver

As required by clause 6.17.2 of the National Electricity Rules (NER), the AER published the *Ring-fencing Guideline – Electricity Distribution* in November 2021. Clause 6.17.1 of the NER requires *DNSPs* 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 *DNSPs* to functionally separate the offices, staff, and branding and cross-promotion activities of direct control services from contestable electricity services. *DNSPs* must also ensure that any new or varied agreements with service providers include provisions requiring the service provider to comply with the 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 July 2024 to 30 June 2029 (the entire 2024–29 regulatory control period) as allowed for by clause 5.3.4(b), such that it continues on from the current waiver, which expires on 30 June 2024. These dates allow the waiver to operate for the longest duration possible, given that we do not foresee any change in the Essential Water service during this timeframe.

## 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 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:

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

3. Whether the benefit, or likely benefit, to electricity consumers of the *DNISP* complying with the obligation (including any benefit, or likely benefit, from increased competition) would be outweighed by the cost to the *DNISP* of complying with that obligation.’

In addition, in section 5 on page 55 of the *Electricity Distribution Ring-Fencing Guideline – Explanatory Statement November 2016* (Explanatory Statement), 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 states on page 55 of the Explanatory Statement: ‘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 *DNISP* that are also regulated services, whether regulated by us or by another economic regulator.’ In addition, on page 57, 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. On page 55, it is also noted that ‘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 *DNISP* providing other services which are also regulated services, such as a *DNISP* with a gas or water network business, we will only grant a waiver subject to the *DNISP* agreeing to establish a [cost allocation method] CAM that deals with all of its regulated services.’

Essential Energy’s request for a waiver for the legal and functional separation obligations meet the AER’s criteria for granting a waiver:

- Essential Water is a water network business regulated by the Independent Pricing and Regulatory Tribunal 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 involvement of multiple regulatory regimes. To comply with the Essential Energy and Essential Water businesses’ regulatory requirements, each business will continue to produce separate regulatory accounts. This separation will continue because both businesses are operating within different revenue setting and pricing rules. Separate regulatory accounting differentiates each business’s costs of providing services and their revenues. While separate regulatory accounting is 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 NER requirements. Essential Energy confirms that it will maintain accounting separation for the Essential Water and Essential Energy businesses, with separate regulatory accounts. The NER, associated comprehensive AER guidelines for regulatory accounts, and the CAM 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.
- Essential Energy’s electricity consumers are unlikely to benefit from complying with the legal separation and functional separation obligations because they would incur costs that would need to be recouped.
- There will be no impact on contestable markets in granting the waiver, given the monopoly nature of the Water business.
- Granting 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 create an additional layer of regulatory compliance that comes with costs. These additional costs for establishing and operating 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 registering a new legal entity
  - changes to the finance systems, procedures and processes to maintain two separate legal entities
  - taxation grouping requirements
  - separate governance processes such as for the Board of Directors and committees
  - splitting, transferring or renegotiating existing contracts and guarantees
  - bank and debt funding arrangements
  - changes in payment channels
- ongoing costs associated with maintaining two legal entities such as:
  - preparing and auditing separate statutory accounts
  - preparing and auditing consolidated statutory accounts
  - preparing separate taxation returns and associated matters
  - maintaining separate governance processes and internal controls management
  - maintaining 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:

- separating employees' office spaces – this may require partitioning off sections of already leased or owned property, or leasing or buying new office space. New fit-outs and security measures would be required if partitioning leased or owned spaces. Leasing or buying more office space would also incur additional ongoing costs that would need to be funded by customers and councils
- separating staff between regulated activities and the Water business
- rebranding and/or advertising – we would need to create and implement a new brand and website for Essential Energy or Essential Water.

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

Essential Energy does not propose to undertake any additional measures on the granting of this waiver, but we reaffirm our commitment to existing protections by:

- maintaining a CAM that covers all services offered by the business, including the Essential Water business
- maintaining separate accounting practices for the Essential Water business
- maintaining 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 in relation to competition, given that 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
3. the administrative costs of complying with clauses 3.1, 4.2 and 4.4.1(a) of the Guideline (which will be avoided with a waiver) outweigh the benefit of achieving compliance.

Essential Energy therefore submits that granting a waiver for 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>DN</i> SP is applying for a waiver	3.1
The reasons why the <i>DN</i> SP is applying for the waiver	5.1
Details of the service, or services, in relation to which the <i>DN</i> SP 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>DN</i> SP 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	3.2
Any additional measures the <i>DN</i> SP proposes to undertake if the waiver were granted	5.4
The reasons why the <i>DN</i> 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	5.2