Ms Anthea Harris
Chief Executive Officer
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

By email to: ringfencing@aer.gov.au

16 August 2023

Dear Ms Harris

Application for Waiver

ActewAGL Distribution (AAD) seeks a waiver from compliance with the requirement in clause 3.1 of the Ringfencing Guideline Version 3, for legal separation between electricity distribution and gas services. Accordingly, we have attached an application to allow AAD's gas business to remain within AAD.

We trust that the application is self-explanatory however we are available to explain and discuss the application as needed. If you have any comments or questions, I suggest that they be directed in the first instance to Bruce Hansen, Group Manager Gas Networks at; bruce.hansen@evoenergy.com.au.

Yours sincerely

Sam Sachse
Acting Chief Executive Officer

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Jemena Networks (ACT) Pty Ltd (ABN 24 008 552 663) and Icon Distribution Investments Limited (ABN 83 073 052 224) t/as Evoenergy (ABN 76 670 568 688).

AAD Application for Ring-fencing Waiver Variation

Legal separation of ActewAGL Distribution's gas business.

The Australian Energy Regulator (AER) updated the Ring-fencing Guideline, Electricity Distribution Version 3 (the Guideline) in November 2021. The Guideline is binding on distribution network service providers (DNSPs) and seeks to promote competition in the provision of electricity services, whilst preventing DNSPs from providing competitive advantages to its affiliates operating in unregulated markets.

A key objective of ring-fencing is to provide a level playing field for participants in contestable electricity markets through accounting and functional separation of the provision of direct control services by DNSPs from the provision of other distribution services by them, or their affiliated entities.

ActewAGL Distribution (AAD) is seeking a waiver of compliance with the following obligations under the Guideline:

3.1 Legal separation

(b) Subject to this clause 3.1, a DNSP may provide distribution services and transmission services, but must not provide other services.

This document is an application:

- for a waiver from the obligation for AAD to legally separate its electricity distribution business and gas business; and
- to allow AAD to continue to provide the gas services, described in section 2.3 below, and electricity distribution services within the same legal entity.

AAD understands that this obligation prohibits distribution network service providers (DNSPs) from providing services other than distribution services and transmission services (referred to as 'other services' in the Guideline).

AAD owns gas distribution assets, including:

- natural gas distribution pipelines located in the ACT and the Queanbeyan-Palerang Regional Council area east of Canberra (ACT Gas Network) and;
- natural gas distribution pipelines located in the Nowra network in the Shoalhaven City Council area on the NSW south coast (Nowra Gas Network).

This application to vary the existing waiver refers to these distribution pipelines as 'the gas business.'

The operation and maintenance of the gas business is wholly outsourced to Jemena Asset Management Pty Ltd (Jemena), who subcontract some of the required gas field services to Zinfra Pty Ltd (Zinfra).

The gas business provides the following gas distribution services:

- reference services (which is a pipeline service that is likely to be sought by a significant part of the market) – haulage reference services; and
- non–reference services (which are pipeline services that are not likely to be sought by a significant part of the market) – interconnection of embedded network services and negotiated services, and;
- other gas services include connections services under part 12A of the National Gas Rules.

The haulage reference services includes:

- receiving gas injected into the pipeline from a different gas pipeline or other gas facility (the point of injection is referred to as the "receipt point"), and;
- transportation of gas in the pipeline from a receipt point to a delivery point;
- allowing the withdrawal of gas from the pipeline at a delivery point, and;
- meter reading and associated data services, along with the provision and maintenance of a standard metering installation; and;

- other specific network user requested activities (ancillary reference services) which include special meter reads, disconnections, reconnections, decommissioning and meter removals, and requests for service.

This document outlines:

a) The obligations in respect of which AAD is applying for a waiver;
b) The reasons AAD is applying for a waiver;
c) The details of the services in relation to which AAD is applying for a waiver;
d) The proposed commencement and expiry dates of the waiver, including the reasons for those dates;
e) The costs associated with AAD complying with the relevant obligation if the waiver were to be refused;
f) The regulatory control period to which the waiver would apply;
g) Additional measures AAD proposes to undertake if the waiver were granted; and
h) The reasons AAD considers the waiver should be granted.

Applicant Information

1	**Name(s)**	Jemena Networks (Act) Pty Ltd and Icon Distribution Investments Ltd form the ActewAGL Distribution Partnership trading as Evoenergy.
2	**The obligation in respect of which AAD is applying for a waiver**	AAD applies for a variation to the existing waiver of obligation 3.1(b) of the Guideline Version 3, which prohibits distribution network service providers (DNSPs) from providing services other than distribution services and transmission services (referred to as 'other services' in the Guideline). 'Other services' for the purpose of this application relates to AAD's gas business.
3	**Reason for waiver**	To comply with clause 3.1(b) of the Guideline in relation to its gas business, AAD would need to either: establish a new legal entity and transfer the gas business to that entity, or; obtain a waiver for that obligation in accordance with the Guideline. AAD wishes to apply for an extension of the existing waiver for compliance with clause 3.1(b) in relation to the gas business; enabling the gas business to remain owned by AAD.
4	**Details of the service, or services, in relation to which the DNSP is applying for variation of the waiver:**	Natural gas distribution pipelines located in the ACT and the Queanbeyan-Palerang Regional Council area east of Canberra (ACT Gas Network) and natural gas distribution pipelines located in the Nowra network in the Shoalhaven local government area on the NSW south coast (Nowra Gas Network). The majority (>80%) of the gas pipeline networks are located within the jurisdiction of the ACT.
5	**The proposed commencement date and expiry date of the waiver with reasons for those dates:**	AAD proposes the waiver commences as soon as practicable, but no later than 1 July 2024 with consideration of the expiration to the existing waiver. AAD proposes that the waiver apply for at least the next two (2) regulatory periods at which point the AER can reassess the appropriateness of the waiver. This is consistent with the approach set out in the Explanatory Statement to the Guideline. It should also be noted that the future of gas in the ACT has a considerable amount of uncertainty due to the ACT Government's preferred Greenhouse Gas (GHG) reduction policy through electrification, and the expected

legislative prohibition of new gas connections from November 2023. The transfer of energy services and associated demand from the gas network to the electricity network can be better understood under the current arrangements.

Supporting information for waiver application

6	**Costs if waiver not granted**	If this application for extension to the existing waiver was to be refused, AAD would incur several significant one-off transaction costs, higher ongoing operating costs, and loss of operational efficiencies as a direct result of having to separate the gas business from the electricity distribution business. **Transaction costs** One off transaction costs that would be incurred by AAD include: • Stamp duty, and capital gains tax upon transfer of the gas assets related to the Nowra Gas Network which is in NSW. Noting that there is an exemption from taxes for the transfer of assets or liabilities due to ring fencing in the ACT. • The ACT gas network is a key asset of AAD which was vested to AAD by a ministerial declaration under section 11 of the *ActewAGL/AGL Partnership Facilitation Act 2000* (ACT). The continued ownership of the asset by AAD was a key principle embedded in the suite of agreements by which AAD was established in 2000. If this asset was to be excised from the AAD partnership, it would require a fundamental re-structure of these suite of agreements and would require actions to reverse the ministerial vesting under the *ActewAGL/AGL Partnership Facilitation Act 2000* (ACT), which would be complicated and a significantly costly processes to undertake. • Application fees and legal work related to making an application to the Foreign Investment Review Board (FIRB) for establishment of a separate foreign controlled legal entity for the separated business would also need to take place. • The establishment of financial arrangements for the new legal entity to purchase the gas business assets from AAD, offset by the sale receipts from the gas business.

- AAD's Nowra gas network is located within a small localised regional gas network serving a small residential customer base with low levels of gas consumption and low revenues which, as mentioned above, are very small compared to electricity distribution services revenues. Natural gas distribution services are directly substitutable by electricity distribution services supplied by other distribution firms and bottled gas providers. Gas distribution is not an essential service to this area.

Ongoing operating costs

There would be considerable ongoing costs associated with legal separation of AAD's gas business. These include the duplication of corporate overhead costs across AAD and the separate legal entity, such as costs for audit and accounting, reporting, taxation, legal, and company secretarial services.

As has been explained above, the small scale of AAD increases the importance of retaining these operational efficiencies. Separating the gas business into a separate legal entity would disadvantage the business when procuring operational services in the ACT.

Given the considerable reduction in purchasing power, the legally separated entity would be less able to procure the required quality of service that the gas business needs without facing higher costs. This would be to the detriment of both gas and electricity consumers in the ACT.

Loss of operational efficiencies

Although existing arrangements for outsourcing AAD's gas services may not change if there were legal separation, there are significant corporate operational expenditure efficiencies gained from retaining AAD's gas and electricity distribution services within the same legal entity.

By way of example, costs associated with audits, regulatory support, employing and leasing premises for corporate services staff would be higher because of the loss of economies of scale that would result from the removal of the common/shared service approach. This would disproportionally affect the gas business because of its significantly smaller size compared to the electricity business. The gas businesses revenues are around 16% of the revenues of the electricity network services.

Retaining these operational efficiencies within one entity, would promote efficient investment in, and efficient operation and use of electricity services

		for the long-term interests of consumers of electricity services, as well as efficient investment in, operation and use of gas services for the long-term interests of consumers of those gas services. AAD is the smallest electricity network firm in the National Electricity Market (NEM). The relatively small scale of AAD's combined operations increases the importance of retaining the operational efficiencies associated with jointly providing gas services and electricity distribution services compared to larger distribution firms operating within the NEM. AAD's customers benefit from these economies of scale and efficiencies in relation to AAD's provision of energy distribution services. This waiver enables customers to continue to benefit directly from AAD delivering both gas and electricity distribution services under the same operating model.
7	**The regulatory control period(s) to which the waiver would apply**	The period to which the waiver would apply is AAD's upcoming regulatory control period and the subsequent regulatory control period; being 2024-29 and 2029-34, respectively.
8	**Additional measures the DNSP proposes to undertake if the waiver were granted**	AAD will continue our ongoing commitment to compliance and transparency with the AER's ringfencing guidelines.
9	**The reasons why the DNSP considers the waiver should be granted**	AAD considers that the waiver should be granted for a number of reasons including: • the 'harm' which the obligation is designed to prevent does not arise in this case because, the gas distribution services are already subject to economic regulation by the AER, and; • the actual provision of the gas distribution services continues to be wholly outsourced by AAD to third parties, providing effective contractual and financial separation from AAD, and; • AAD's Cost Allocation Methodology (CAM) already deals with, and will continue to deal with, the allocation of costs to its regulated services (including its gas business).

Each of these reasons is discussed in further detail below.

- **Harm to be addressed by the obligation.**
  The 'harm' that legal separation is intended to prevent is cross subsidisation (i.e., preventing a DNSP from providing other services - in this case, gas services that could be subsidised by its electricity distribution services). There is minimal risk of AAD using its electricity distribution services to subsidise its gas business services as both are subject to economic regulation by the AER **Economic regulation by the AER**
  The gas business is subject to two different economic regulatory arrangements:
- Part 9 of the National Gas Rules applies to covered pipelines such as AAD's pipelines in the ACT and Queanbeyan-Palerang region, and;
- Part 10 of the NGR will apply to uncovered pipelines such as AAD's pipelines in the Shoalhaven region.

Regulation of pipelines in the ACT and Queanbeyan-Palerang region
Part 9 of the National Gas Rules requires AAD to periodically submit an access arrangement proposal to the AER for its pipelines in the ACT and Queanbeyan-Palerang Regional Council area. The AER regulates AAD's reference tariffs and revenue for its gas business under an approved access arrangement.

The gas information that AAD provides to the AER includes extensive financial and non-financial data in the form of Regulatory Information Notices (RIN), along with other information formally requested from time to time by the AER. This promotes transparency and accountability and provides the AER with the ability to identify and address any potential concerns in relation to the electricity distribution business subsidising the gas business. This information, along with the AER's revenue determinations for gas, is available to the public on the AER's website. Further, the reference tariff applied by AAD for gas distribution services for the ACT Gas Network are approved by the AER on an annual basis. AAD offers the same published reference tariffs to all retailers operating in the ACT and Queanbeyan-Palerang Regional Council area.

AAD's gas business is also subject to ring fencing requirements under the National Gas (South Australia) Act 2008 (SA) that are similar to the ring-fencing requirements under the Guideline. By way of example, Division 2 of that Act prohibits the carrying on of a gas related business, prohibits marketing staff from taking part in gas related businesses, and requires accounts to be prepared, maintained and kept separate. The AER's role in determining the ring-fencing obligations applicable to AAD's gas business is reflected in Part 5 of the National Gas Rules.

AAD submits to the AER annual compliance reports regarding duties of pipeline service providers, structural and operational separation requirements, access arrangements and determinations. These reports are in response to AERs annual regulatory information order under section 48 of the National Gas Law. The AER review the reports and publish their findings annually.

Regulation of pipelines in the Shoalhaven region

Recent reforms to the gas pipeline regulatory framework have resulted in changes to service providers obligations. Changes were made to both the National Gas Law (NGL) and National Gas Rules (NGR) in March 2023. The gas pipeline reforms simplify the regulatory framework so that there are now only two forms of regulation that may apply to gas pipelines:

1. Scheme pipelines – similar to full regulation pipelines under the previous framework.

2. Non-scheme pipelines – similar to non-scheme pipelines under the previous framework but also including pipelines that were previously under light regulation.

Part 10 of the NGR applies to both scheme and non-scheme pipelines. It requires service providers to publish and maintain:

- service and access information
- the actual provision of the gas services
- standing terms
- financial information, historical demand information and a cost allocation methodology
- actual prices payable information

Part 11 covers the access negotiation framework all pipelines must comply with.

Ring fencing provisions are covered in Part 5 (Part 6 of the previous NGR) and include two new rules which set out exemptions from ring-fencing and associated contract provisions.

As mentioned above, the provision of gas distribution services using AAD's pipelines has been wholly outsourced since AAD was established in 2000, and there are no plans to change this arrangement. This arrangement is formalised in a contract between AAD and Jemena (known as the Distribution Asset Management Services (DAMS) Agreement). Whilst this structure does not legally separate ownership of the businesses, they do contractually, financially, and practically separate the provision of gas services from the provision of electricity distribution services. As such, it adds an extra control over the risk of cross subsidy. We note that the legal separation provisions of section 3 of the Guideline are not concerned with separation of ownership (sometimes referred to as structural separation) but rather separation of services.

The conclusion from the above is that there is no identifiable harm to be avoided by requiring AAD's gas business to be legally separated from its electricity distribution business.

Such a requirement would not advance the policy objectives underlying clause 3.1(b) of the Guideline. Requiring the legal separation of the AAD gas business from the electricity distribution business will cause each business to incur additional costs (i.e., costs it would not need to incur but for the obligation to legally separate) and reduce the efficiency of both businesses without delivering any increase in benefits to electricity or gas consumers.

AAD's Cost Allocation Methodology

The AER, in the Explanatory Statement to the Guidelines, stated that it will only grant a waiver in respect of a DNSP providing other services, which are also regulated services, subject to the DNSP agreeing to establish a CAM that deals with all its regulated services.

AAD's CAM allocates corporate services between all its business activities that use these services, including separate allocations for its electricity distribution business and gas business. The CAM covers the allocation and attribution of all shared costs related to AAD's gas business regardless of the location of the relevant pipeline or assets.

The CAM also explains the drivers behind the cost allocations.

AAD has implemented these additional requirements for the following internal reasons:

- The outsourcing of the operation of the gas business under the Distribution Asset Management Services (DAMS) Agreement with Jemena requires clear and transparent cost allocations.
- Due to the different ownership of businesses, to which AAD provides corporate services, the allocation of corporate services costs across different businesses needs to be clear and transparent.
- These multiparty arrangements require a high level of visibility and due diligence in implementation to ensure there are no cross subsidies that could impact different owners inappropriately.

As required by clause 6.15 of the NER and the AER's cost allocation guidelines, AAD's CAM has been approved by the AER. AAD continues to apply the approved CAM and cost allocation principles accurately through the audit and verification requirement set out in clause 3.2(a)(7) of the AER's cost allocation guidelines.

10	**Any other information**	Nil to report.